

John Zerwas, M.D.
Chairman



Oscar Longoria
Vice Chairman

**TEXAS HOUSE OF REPRESENTATIVES
COMMITTEE ON APPROPRIATIONS**

AGENDA

WEDNESDAY, APRIL 18, 2018
10:00AM

I. CALL TO ORDER

II. CHAIRMAN'S OPENING REMARKS

III. *Continue to study strategies to use the Economic Stabilization Fund (ESF) to generate additional revenue for state obligations without compromising the fund's intended purpose. Evaluate the current methodology used to set the ESF cap. (Interim Charge 2)*

LEGISLATIVE BUDGET BOARD

- URSULA PARKS, EXECUTIVE DIRECTOR

TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

- THE HONORABLE GLENN HEGAR, COMPTROLLER

TEXAS TAXPAYERS AND RESEARCH ASSOCIATION

- DALE CRAYMER, PRESIDENT

IV. *Examine the use of one-time funding and deferral measures employed by the Legislature in the state budget for the 2018-19 biennium, as well as any other factors that may contribute to a structural deficit. Explore strategies to ensure the state's ability to meet its ongoing fiscal obligations. (Interim Charge 3)*

LEGISLATIVE BUDGET BOARD

- SARAH KEYTON, ASSISTANT DIRECTOR

TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

- GLENN HEGAR, COMPTROLLER

TEXAS TAXPAYERS AND RESEARCH ASSOCIATION

- DALE CRAYMER, PRESIDENT

V. *Monitor the ongoing implementation of Article IX, Sec. 9.13 of the General Appropriations Act and determine if state agencies are realizing cost savings and/or security enhancements in state operations related to cybersecurity, information technology, and cloud computing. Study trends in cloud computing and IT delivery services, and identify whether additional cost efficiencies, economies of scale, or IT modernization could be achieved. (Interim Charge 5)*

LEGISLATIVE BUDGET BOARD

- RICHARD CORBELL, SUPERVISOR

TEXAS DEPARTMENT OF INFORMATION RESOURCES

- STACEY NAPIER, EXECUTIVE DIRECTOR
- TODD KIMBRIEL, DEPUTY EXECUTIVE DIRECTOR & STATE CHIEF INFORMATION OFFICER

- VI.** *Monitor the ongoing implementation of S.B. 20 (84R), S.B. 533 (85R), and S.B. 255 (85R), as well as Article IX, Sections 7.04, 7.10, and 7.12 of the General Appropriations Act. Study the processes by which state agencies award, execute, manage, and monitor state contracts, and make recommendations on whether any changes are necessary to safeguard the best interest of the public and state. Evaluate measures utilized to determine vendor performance, and make recommendations on how to improve vendor selection and performance. When reviewing the Health and Human Services Commission's (HHSC) managed care contracts, determine if HHSC has adequate data, staff, and processes to provide appropriately rigorous contract oversight, including but not limited to the use of outcome metrics. Consider whether HHSC properly enforces contractual sanctions when managed care organizations (MCOs) are out of compliance, as well as how HHSC uses Medicaid participants' complaints regarding access to care to improve quality. (Interim Charge 4)*

LEGISLATIVE BUDGET BOARD

- BEN CROSS, ANALYST

TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

- ROBERT WOOD, DEPUTY COMPTROLLER FOR OPERATIONS AND SUPPORT

HEALTH AND HUMAN SERVICES COMMISSION

- CHARLES SMITH, COMMISSIONER
- RON PIGOTT, DEPUTY EXECUTIVE COMMISSIONER FOR PROCUREMENT AND CONTRACTING SERVICES
- SYLVIA HERNANDEZ KAUFFMAN, INSPECTOR GENERAL

- VII.** *Continue to evaluate the effectiveness of state agencies' use of funds appropriated during the 85th Legislative Session for border security operations. Examine existing data and reporting on border security metrics. Monitor federal efforts to enhance security along the Texas-Mexico border to ensure that state resources are utilized optimally. (Interim Charge 6)*

LEGISLATIVE BUDGET BOARD

- ANGELA ISAACK, MANAGER

TEXAS DEPARTMENT OF PUBLIC SAFETY

- STEVE MCCRAW, DIRECTOR
- SUZY WHITTENTON, CHIEF FINANCIAL OFFICER

TEXAS MILITARY DEPARTMENT

- ADJUTANT GENERAL, MAJOR GENERAL JOHN F. NICHOLS
- BILL WILSON, EXECUTIVE DIRECTOR

TRUSTEED PROGRAMS WITHIN THE OFFICE OF THE GOVERNOR

- NANCY CARRALES, EXECUTIVE DIRECTOR OF THE HOMELAND SECURITY GRANTS

TEXAS PARKS AND WILDLIFE DEPARTMENT

- COLONEL GRAHAME JONES, DIRECTOR OF LAW ENFORCEMENT

TEXAS ALCOHOLIC BEVERAGE COMMISSION

- A. BENTLEY NETTLES, EXECUTIVE DIRECTOR

VIII. CLOSING REMARKS AND ADJOURNMENT



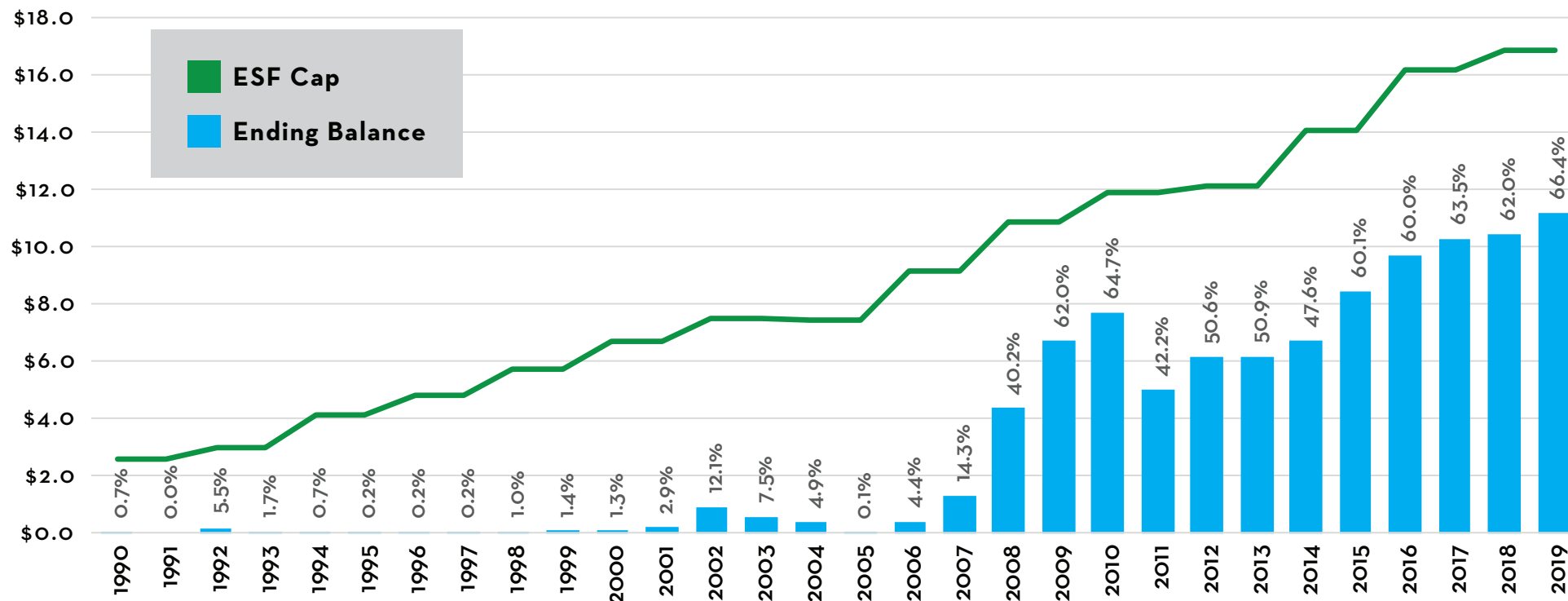
ECONOMIC STABILIZATION FUND (ESF) OVERVIEW

The Texas Economic Stabilization Fund (ESF) was established by the passage of a constitutional amendment in **1988**. Since its establishment, deposits to the fund have totaled **\$20.9 billion**. The Texas Legislature has passed eight bills appropriating **\$11.6 billion** from the fund. The 2017 balance (**\$10.3 billion**) is the **largest** among all state stabilization funds and **third largest** as a percentage of state expenditures (**19.2%**).

In November 2016 a sufficient balance in the ESF of **\$7.5 billion** was adopted. If the balance falls below this amount, deposits to the ESF are increased until the balance is reestablished. The maximum balance for the 2018-19 biennium is **\$16.9 billion**.

Historically, the ESF has been held in the Treasury Pool, a low risk, high liquidity cash equivalent fund. Beginning in 2016, a portion of the ESF exceeding the Sufficient Balance has been invested outside of the Treasury Pool in less liquid, higher yielding fixed income assets.

ESF ENDING BALANCE VS. CAP (IN BILLIONS)



\$16.9 BILLION

2018-19 MAXIMUM BALANCE

\$7.5 BILLION

2018-19 SUFFICIENT FUND BALANCE

AUG 31, 2017 ESF BALANCE

\$10.3 BILLION

\$8.2 BILLION TREASURY POOL

\$2.1 BILLION NON-TREASURY POOL

40 STATES

CAP THEIR STABILIZATION FUND

5%-10%

OF ANNUAL

REVENUE OR EXPENDITURE

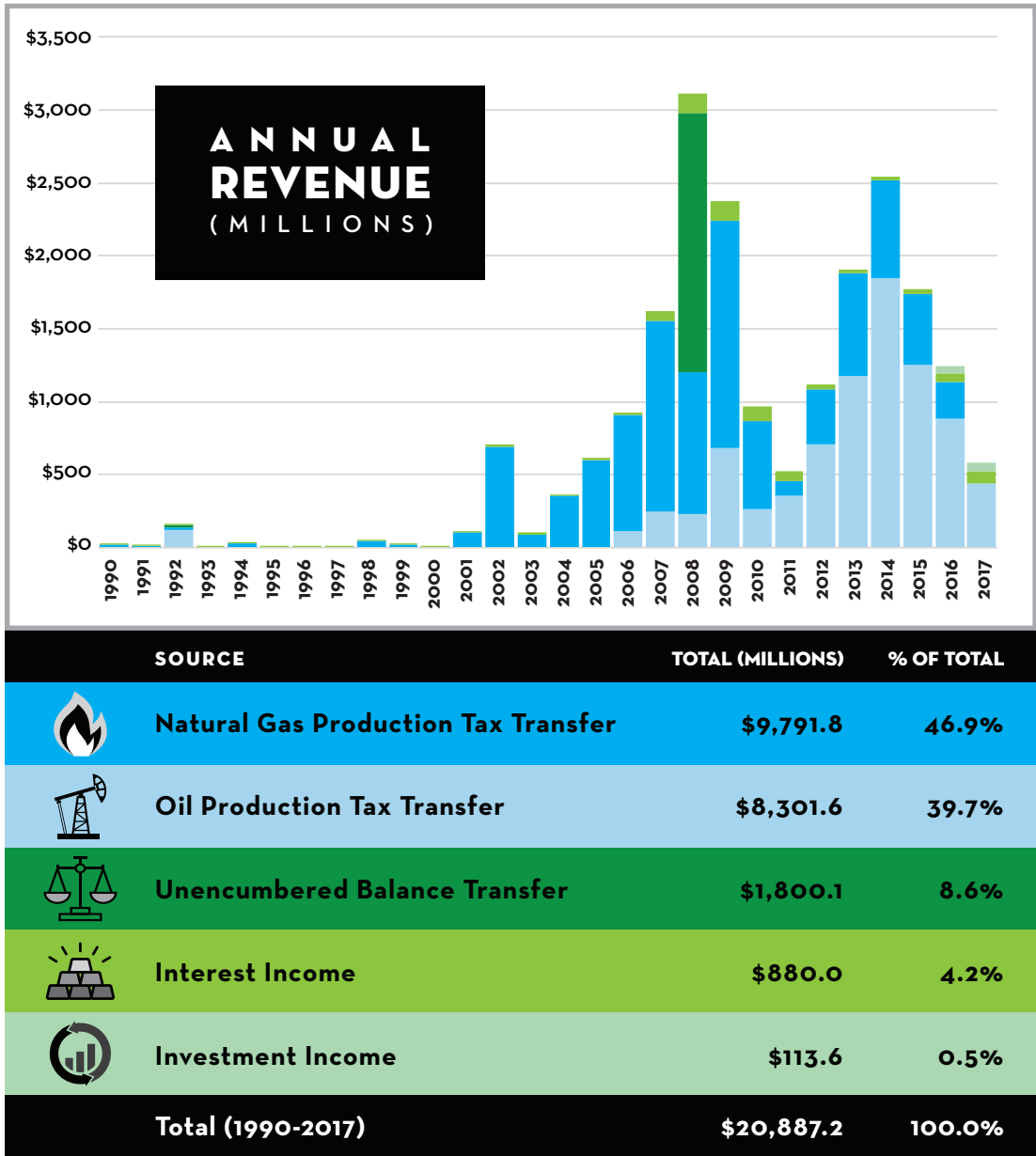
TEXAS

BIENNIAL CAP

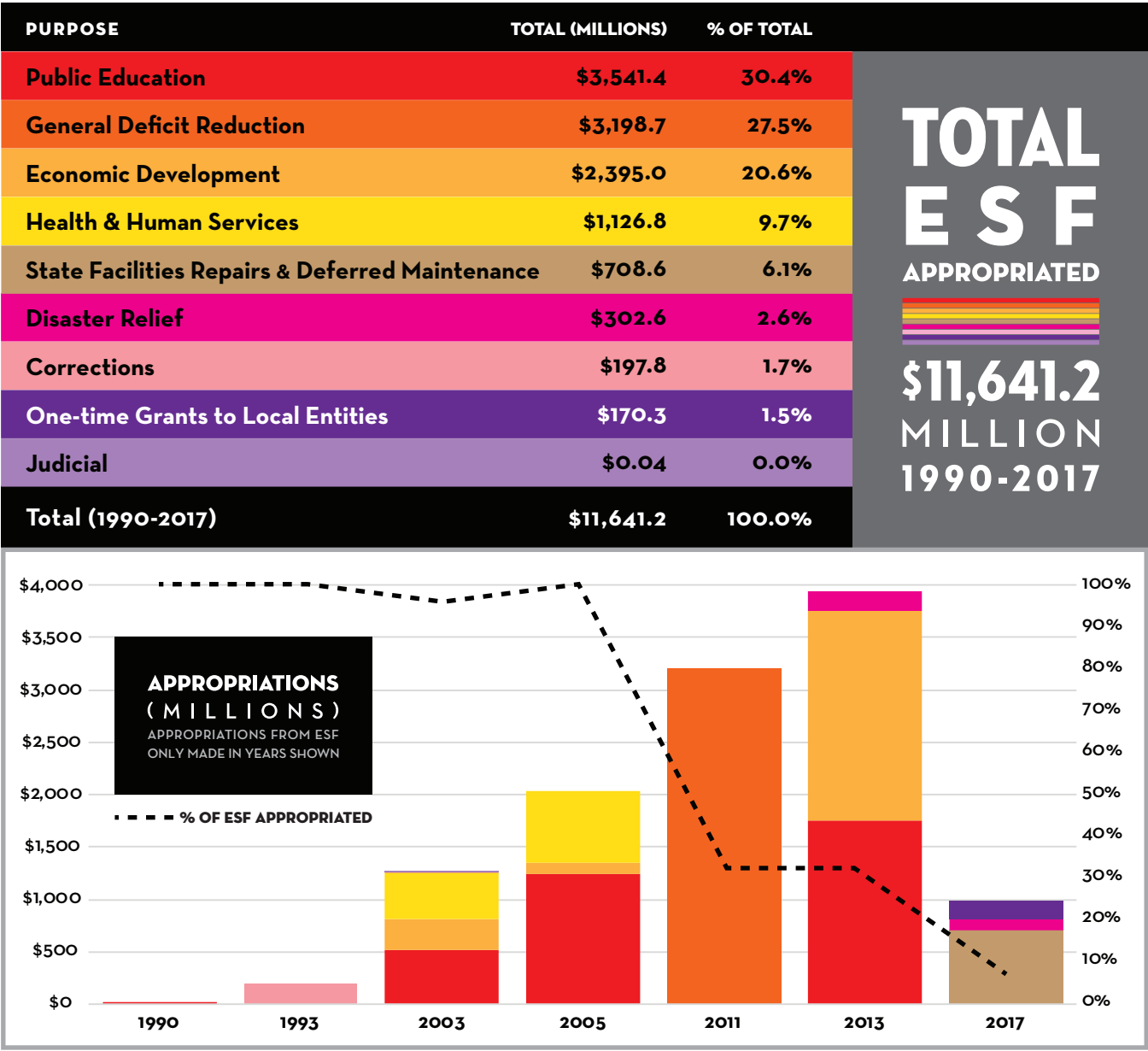
10% OF BIENNIAL GR DEPOSITS



REVENUE where does it come from?



APPROPRIATIONS where does it go?





LEGISLATIVE BUDGET BOARD

Funding Measures

PRESENTED TO HOUSE COMMITTEE ON APPROPRIATIONS

LEGISLATIVE BUDGET BOARD STAFF

APRIL 2018

Statement of Interim Charge

Examine the use of onetime funding and deferral measures employed by the Legislature in the state budget for the 2018–19 biennium, as well as any other factors that may contribute to a structural deficit.

Explore strategies to ensure the state's ability to meet its ongoing fiscal obligations.

Transportation

- Voter approval of amendments to the Texas Constitution proposed by Senate Joint Resolution 5, Eighty-fourth Legislature, 2015, directed that a portion of sales tax and motor vehicle sales tax are to be deposited to the State Highway Fund (SHF).
- Sales Tax:
 - Beginning in 2018
 - \$2.5 billion each year of the net revenue from the state sales and use tax that exceeds the first \$28.0 billion is transferred
- Motor Vehicles Sales Tax:
 - Beginning in 2020
 - 35.0 percent of the amount collected in state motor vehicle sales tax greater than \$5.0 billion
 - The Comptroller of Public Accounts estimates that, based on historical trends, this amount could be approximately \$142.0 million for the 2020–21 biennium

Sales Tax Transfer Amount to SHF

ESTIMATE SOURCE	2018–19			2020–21				BIENNIAL DIFFERENCE
	2018 COLLECTIONS TRANSFERR ED IN 2019	2019 COLLECTIONS TRANSFERR ED IN 2019	2018–19 APPROPRIATIO NS	2019 COLLECTIONS TRANSFERR ED IN 2020 ED IN 2020 ➔	2020 COLLECTIONS TRANSFERR ED IN 2020	2021 COLLECTIONS TRANSFERRE D IN 2021	2020–21 SHF AVAILABLE FOR APPROPRIATION	
GAA/ BRE	2.2	0.7	2.9	1.8	2.5	2.5	6.8	3.9
CRE	2.3	0.9	3.2	1.6	2.5	2.5	6.6	3.4

Unclaimed Securities and Tax Amnesty

- The 2018–19 General Appropriations Act assumes available onetime revenue of \$500.0 million in General Revenue Funds for the accelerated sale of unclaimed securities and \$46.0 million in All Funds for a tax amnesty program pursuant to the following provisions in Article IX:
 - **Section 17.12. Accelerated Sale of Unclaimed Securities.** \$500,000,000 in General Revenue Funds appropriated elsewhere in this Act is supported by the Comptroller of Public Accounts accelerating the sale of unclaimed securities by at least \$500,000,000 in excess of the Comptroller's January 2017 Biennial Revenue Estimate and any additional general revenue certified as of the date of the enactment of this Act, and depositing those proceeds in the General Revenue Fund.
 - **Section 17.11. Tax Amnesty.** Out of funds appropriated elsewhere in this Act, the Comptroller of Public Accounts shall establish, for a limited duration, a tax amnesty program under the authority of Tax Code Section 111.103, designed to encourage a voluntary reporting by delinquent taxpayers who do not hold a permit, or are otherwise not registered for a tax or fee administered by the Comptroller, or those permitted taxpayers that may have underreported or owe additional taxes or fees. Such a program should provide for the waiver of penalty or interest, or both, but shall not apply to an established tax liability or taxpayers currently under audit review. The amnesty would include tax due from purchases as defined under current state tax statutes. \$27,730,000 in appropriations from the General Revenue Fund made elsewhere in this act and \$18,333,000 in appropriations from the Property Tax Relief Fund made elsewhere in this act are contingent upon the tax amnesty program generating a net increase in available General Revenue Funds in the 2018-19 biennium of at least \$46,063,000 over the Comptroller's January 2017 Biennial Revenue Estimate and any additional general revenue certified as of the date of the enactment of this Act.

General Land Office (School Land Board)

- 2018–19 appropriations for the Foundation School Program (FSP) include \$300.0 million from the Available School Fund, which was contingent on the School Land Board (SLB) at the General Land Office approving a distribution of the same amount directly from the Permanent School Fund assets controlled by the SLB.
- This allowed the General Revenue (Fund No. 193) draw for the FSP to be approximately \$300.0 million less than it otherwise would have been.
- This distribution is at the complete discretion of the SLB pursuant to the Texas Constitution, Article 7, Section 5(g), but may not exceed \$300.0 million per year.
- This is the second time SLB has approved such a distribution (first was in fiscal year 2013).

Deferrals and Supplemental Funding

Deferrals

- In general, a deferral refers to statutorily changing the payment date for an established payment schedule and moves a payment from one fiscal year, typically the past year of the biennium being funded, into the next, typically the first year of the next biennium:
 - A deferral does not create a shortfall that must be paid for in a subsequent supplemental bill
 - A deferral can be, but does not have to be, reversed the following session but must be repaid before this tool is available for use again
 - Deferrals in the Foundation School Program were last used by the Eighty-second Legislature in 2011 and the Seventy-eighth Legislature in 2003

Supplemental Funding

- Costs for an entitlement program that are not fully funded are paid for in a subsequent supplemental bill
- The Legislature may consider supplemental bill requests from agencies for additional costs for non-entitlement programs



LEGISLATIVE BUDGET BOARD

Contact the LBB

Legislative Budget Board

www.lbb.state.tx.us

512.463.1200

Options to Increase Investment Earnings of the Economic Stabilization Fund

Presented to the
House Appropriations Committee

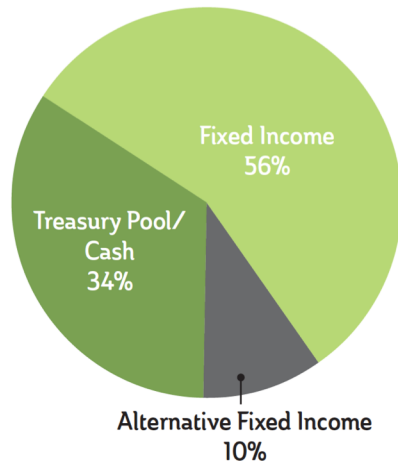
April 18, 2018

Glenn Hegar
Texas Comptroller of Public Accounts

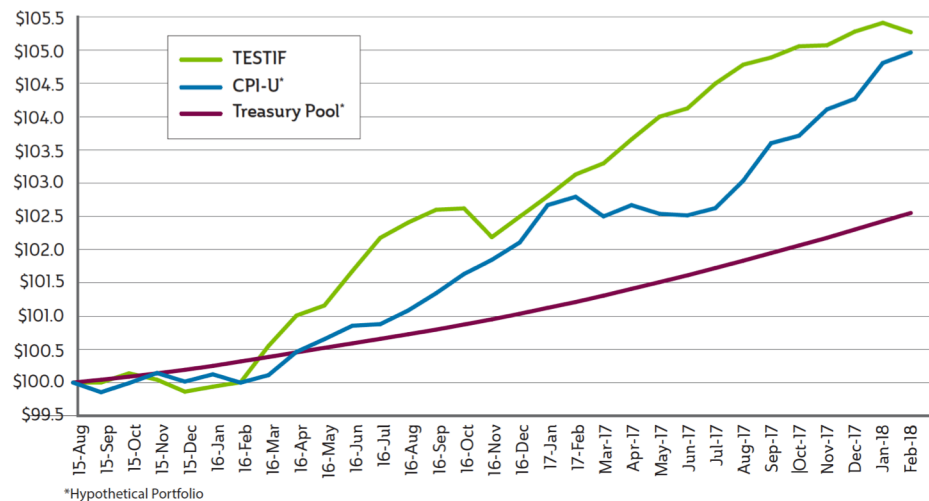
TESTIF Investment Fund

Strategy	Target Asset Allocation	9/30/2015	12/31/2015	12/31/2016	6/30/2017	12/31/2017	2/28/2018
Treasury Pool/Cash	25%	\$1,194,513,946	\$1,605,554,951	\$1,225,243,092	\$1,087,704,607	\$1,076,995,987	\$1,080,138,563
Fixed Income	65%	\$269,569,195	\$920,414,552	\$1,704,282,009	\$1,825,723,667	\$1,843,751,481	\$1,835,311,627
Alt. Fixed Income	10%	0	\$75,097,642	\$214,009,452	\$277,717,866	\$304,716,125	\$309,277,495
<i>ESF Inflows</i>		<i>\$1,464,000,000</i>	<i>\$1,140,000,000</i>	<i>\$475,000,000</i>			
Total		\$1,464,083,141	\$2,601,067,145	\$3,143,534,552	\$3,191,146,141	\$3,225,463,594	\$3,224,727,685

Asset Allocation by Strategy
(as of 2/28/18)



Hypothetical Growth of \$100 Since Inception
(as of 2/28/18)



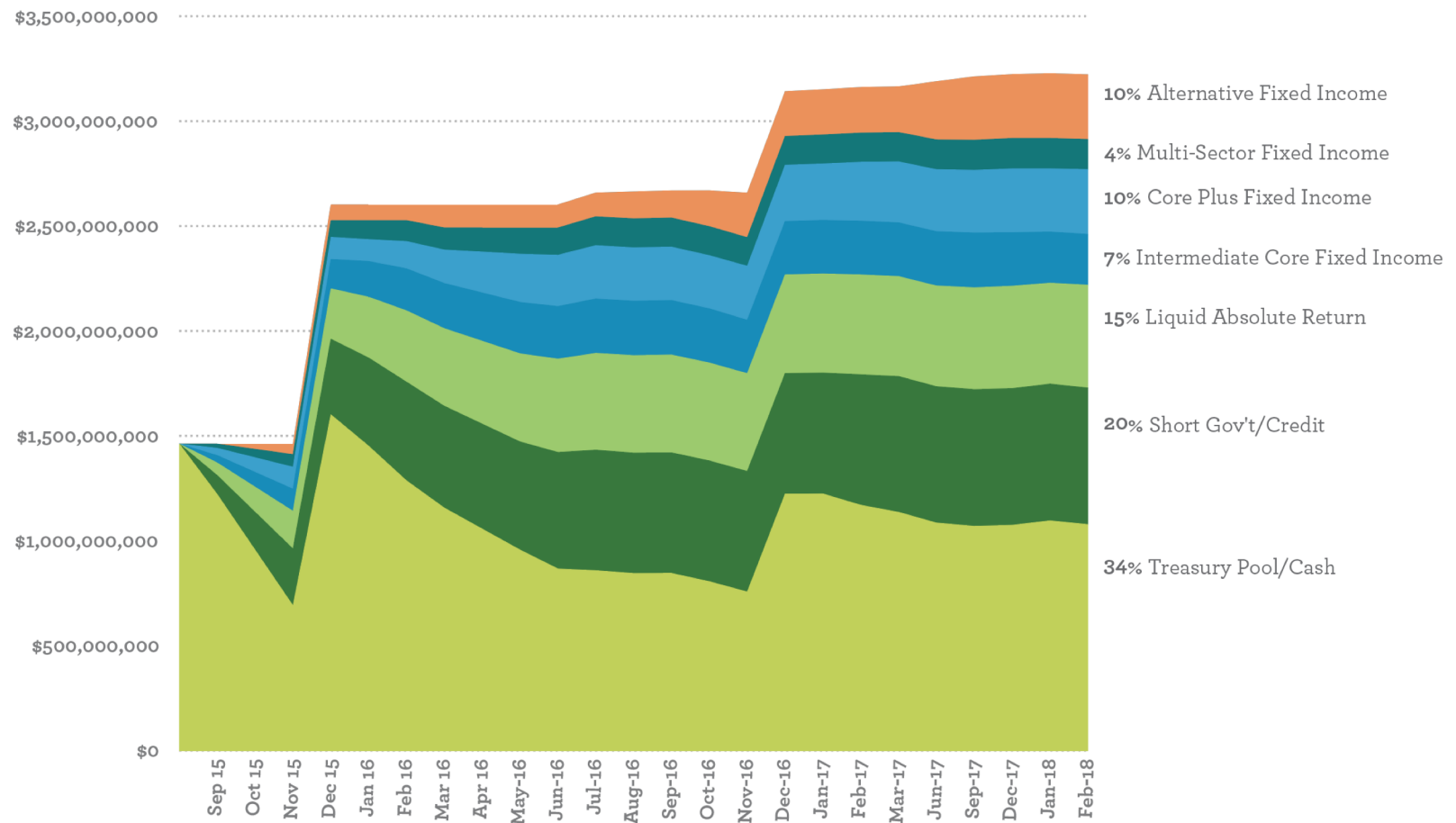
Performance Table

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	Ann. ITD	Cumulative ITD
2015									0.01%	0.14%	-0.10%	-0.18%	-0.14%		
2016	0.07%	0.07%	0.55%	0.45%	0.15%	0.51%	0.49%	0.23%	0.19%	0.02%	-0.42%	0.30%	2.63%		
2017	0.30%	0.33%	0.11%	0.35%	0.33%	0.12%	0.36%	0.28%	0.10%	0.16%	0.01%	0.20%	2.67%	2.23%	5.28%
2018	0.12%	-0.13%											-0.01%	2.08%	5.27%

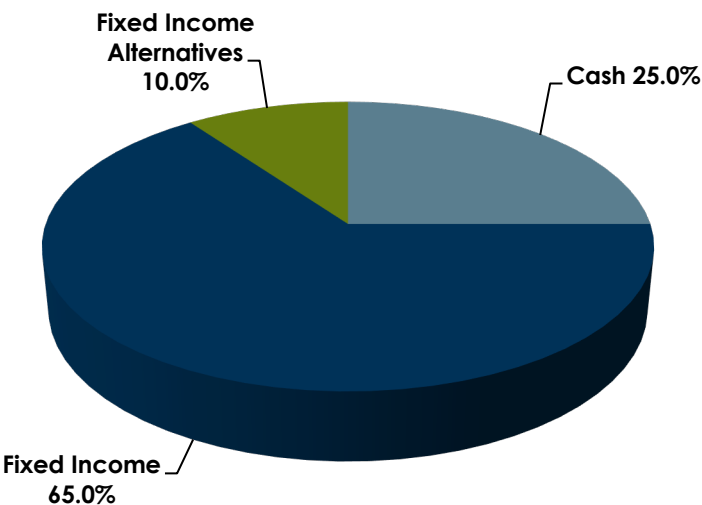
TESTIF Capital Deployment Overview

(Allocated as of February 28, 2018)

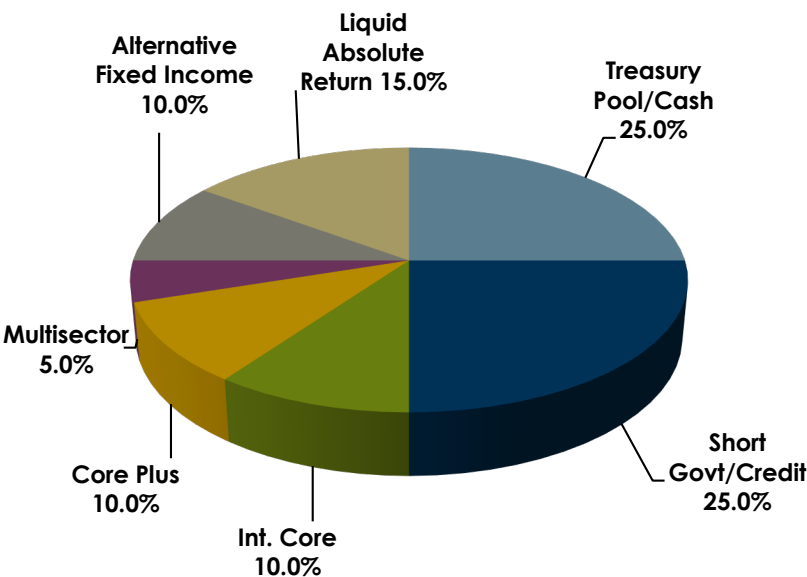
Total AUM: \$3,224,727,685



Portfolio Allocation (Strategic Target)



Portfolio Allocation Detail (Strategic Target)



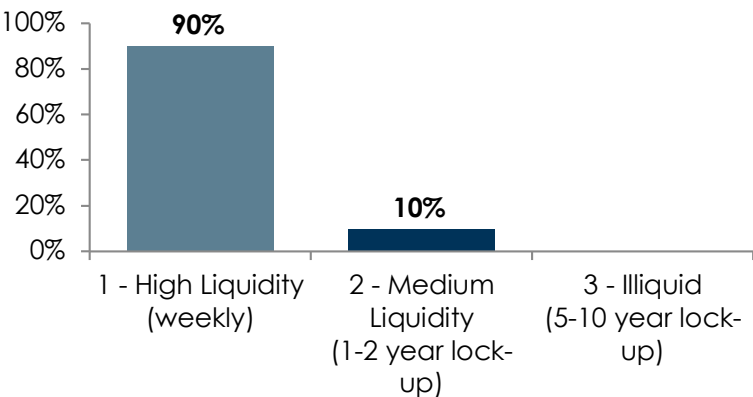
Simulated Portfolio Statistics*

10- Year Median Return	2.5%	Based on intermediate-term assumptions
Standard Deviation	3.6%	
Sharpe Ratio**	0.5	
5th Percentile Return (5-Year)	0.0%	5% chance of average annualized return of 0% or less over five year period

*Based on strategic target allocation and 2018 capital markets assumptions. Future year assumptions will change to reflect market conditions.

**Sharpe Ratio is a measure of risk-adjusted return.

Liquidity



Immediate threats to Texas' AAA credit rating

- Threats identified by the rating firms:
 - Growing long term obligations
 - Above-average pension liabilities and weak funding practices
 - Structural imbalance of the budget
 - Budgetary pressures for education, healthcare and transportation

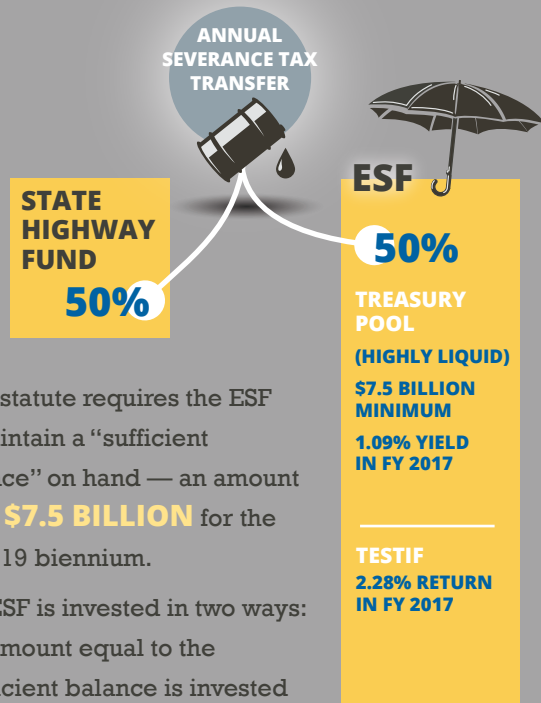
Increased scrutiny regarding long term obligations

- Pensions
 - Rating Criteria changes: Moody's, Standard and Poor's and Fitch have proposed or updated their long-term obligation criteria to expand the weight of pension long-term liabilities.
 - Moody's has noted that contribution levels remain insufficient to prevent unfunded liability growth and that failure to address pension funding could lead to a downgrade.
 - Standard and Poor's notes that the policy to fund to a fixed percent of payroll below actuarially determined levels leads to underfunding of the pension funds.
 - Fitch notes that rising pension liabilities are likely to further increase carrying costs.
- Other Post-Employment Benefits (OPEBs)
 - Standard and Poor's has noted that growing OPEB liabilities are a significant long-term credit pressure for the state.

INVESTING THE ESF

The Comptroller's office proposes a way to use the state's Economic Stabilization Fund (ESF) to generate additional revenue for long-term obligations of the state without endangering the fund's original purpose of protecting state finances against economic shocks.

CURRENT ESF STRUCTURE



State statute requires the ESF to maintain a “sufficient balance” on hand — an amount set at **\$7.5 BILLION** for the 2018-19 biennium.

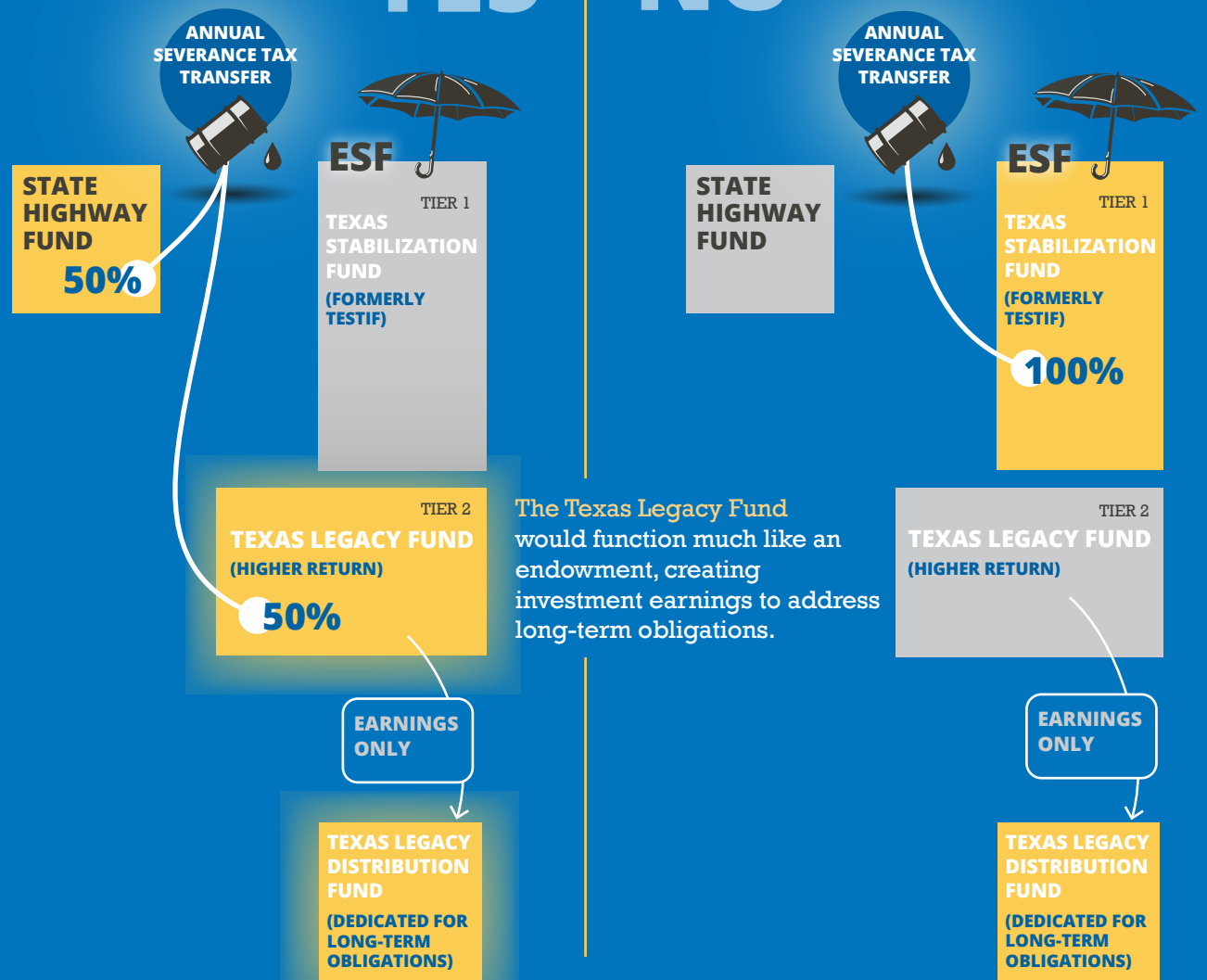
The ESF is invested in two ways:

- an amount equal to the sufficient balance is invested in the Treasury Pool.
- Amounts above the sufficient balance are invested in the Texas Economic Stabilization Investment Fund (TESTIF), which offers a slightly higher return than the Treasury pool.
- TESTIF has two primary performance objectives:
 - 1) maintaining purchasing power; and
 - 2) delivering returns in excess of short-term cash equivalents.

PROPOSED ESF STRUCTURE

AT SUFFICIENT BALANCE ?

YES | **NO**



Texas Legacy Fund & Texas Stabilization Fund

Portfolio Distribution/Growth Summary

Texas Legacy Fund

The table below summarizes the median simulated ending values, annual distribution amounts, and cumulative distribution amounts for the Texas Legacy Fund. Modeling results assume a beginning value of \$3.1

billion and annual contributions consistent with expected state economic growth. Distribution rates represent estimated earnings in excess of those retained to preserve the purchasing power of the Fund.

(\$ millions)	FY 2020	12-year	20-year
Projected Portfolio Value	\$3,076	\$31,618	\$93,929
Projected Year-End Distribution	\$111*	\$997**	\$3,388
Projected Cumulative Distributions	\$111*	\$4,404**	\$22,068

* Expected distribution in 2020-2021 biennium

**Distribution calculated on average 5-year portfolio value

Simulated Portfolio Statistics

10- Year Median Return	6.4%
Standard Deviation	9.8%
Sharpe Ratio	0.6
5th Percentile Return (5-Year)	-1.5%

Texas Legacy Fund Total Return Percentiles

Percentile	1-Year	5-Year	10-Year	20-Year
95th	21.78%	13.34%	11.25%	11.61%
90th	18.71%	11.96%	10.24%	10.83%
50th	7.22%	6.48%	6.41%	7.99%
10th	-6.07%	0.34%	2.09%	5.08%
5th	-10.23%	-1.46%	0.77%	4.26%

Texas Stabilization Fund

The Texas Stabilization Fund is maintained at a value equal to 8% of the estimated biennial general revenue

budget. Values assume no appropriation from the Economic Stabilization Fund.

(\$ millions)	FY 2020	10-year	20-year
Projected Portfolio Value	\$9,245	\$13,584	\$19,959

Simulated Portfolio Statistics

10- Year Median Return	2.5%
Standard Deviation	3.6%
Sharpe Ratio	0.5
5th Percentile Return (5-Year)	0.0%

Texas Stabilization Fund Total Return Percentiles

Percentile	1-Year	5-Year	10-Year	20-Year
95th	8.88%	5.16%	4.35%	5.44%
90th	7.17%	4.55%	3.91%	5.11%
50th	2.15%	2.39%	2.46%	4.06%
10th	-1.63%	0.53%	1.06%	3.06%
5th	-2.57%	0.04%	0.74%	2.77%

Testimony on the Economic Stabilization Fund

Economic Stabilization Fund: Continue to study strategies to use the Economic Stabilization Fund (ESF) to generate additional revenue for state obligations without compromising the fund's intended purpose. Evaluate the current methodology used to set the ESF cap.

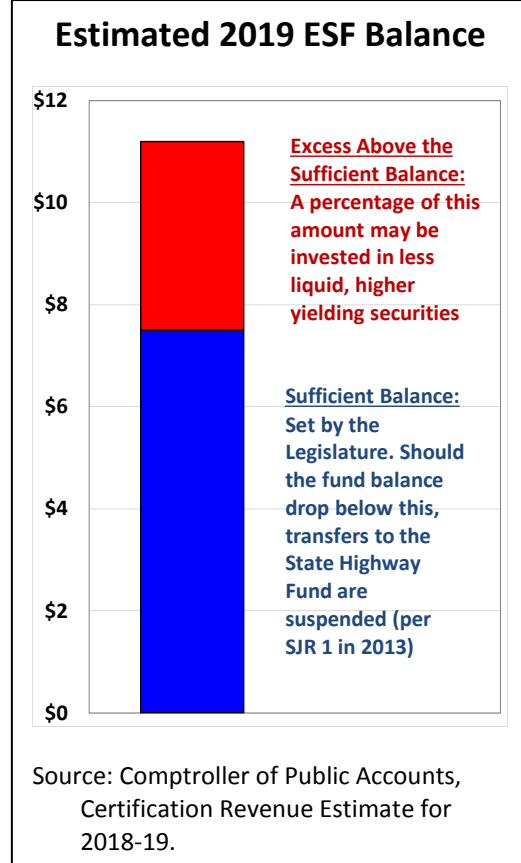
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Strategies to Generate Additional Revenue

The Economic Stabilization Fund (ESF) is generally kept liquid—investing in short term securities so that funds may be accessed and used quickly should the Legislature tap the fund. While this is generally prudent, fund balances have become so substantial that the state has more than sufficient balances to address most immediate needs. Further, legislative appropriations are typically made well in advance of the actual use of an appropriation from the fund, obviating the need for immediate liquidity.

In 2013, as a part of a Constitutional amendment redirecting moneys for deposit into the ESF to be shared with the State Highway Fund, the Legislature was instructed to formally set an amount of “sufficient balance.” Should the fund balance drop below this amount, transfers to the State Highway Fund are suspended. In 2015, HB 903 allowed the Comptroller to invest a percentage of the excess above the sufficient balance in higher-yielding, but generally less liquid, securities.



Recommendations:

1. The legislature should set the “sufficient balance” amount more in line with the historical use of the fund (the greatest single appropriation from the fund to date is \$3.1 billion). This would allow a greater portion of the fund to be invested in higher yielding securities.
2. In the event the Legislature appropriates an amount that would cause the ESF to drop below the sufficient balance, the Comptroller should be allowed to use his discretion to draw from the more liquid moneys in the fund, and not be forced to immediately sell higher-yielding investments because:
 - The economic conditions necessitating the use of the ESF may also mean that the market for securities is temporarily depressed, forcing the state to sell securities at unfavorable terms; and
 - Having to sell the higher-yielding securities also means an appropriation from the ESF will result in a greater revenue loss to the state (because of reduced interest earnings).

Evaluate Alternative Limit Calculations

The balance of the Economic Stabilization Fund is “capped” at:

an amount equal to 10 percent of the total amount, excluding investment income, interest income, and amounts borrowed from special funds, deposited in general revenue during the preceding biennium. (Texas Constitution, Article 3, Section 49-g(g)).

In 1987, when the legislature passed the ESF resolution, this amount was roughly equivalent to what the Legislative Budget Board and the Comptroller define as “general revenue-related” funds (essentially funds affecting the Comptroller’s certification of the budget).

In the ensuing years, the nature of the general revenue fund has changed. In 1987, roughly 2 percent of all federal money received was initially deposited into special funds, and not the general revenue fund. Many of these special funds were consolidated into the general revenue fund in 1991, increasing the amounts deposited into the fund. Today almost two-thirds of all federal money is deposited into the general revenue fund—artificially increasing the cap on the Economic Stabilization Fund by as much as \$5 billion.

Federal revenue should not be included in calculating the limit on the fund because state money is not used to supplant federal funding. The loss of federal funds is not a risk to the general revenue fund, nor would removing them from the general revenue fund create a reduction in funds available for certifying the budget.

Unused excessive balances in the ESF can do harm to the Texas economy. To the extent the money is collected but not used, every dollar in the ESF is a dollar removed from the Texas economy, reducing investment, reducing jobs and reducing incomes.

In 2016, the National Association of State Budget Officers reported that Texas’ balance in the ESF was equal to 18 percent of the state’s annual general revenue expenditures and three times greater than the nationwide average of states with similar funds.

Recommendation:

1. The legislature should create a federal revenue fund outside of the general revenue fund to handle the deposit of federal moneys—as was the case when the ESF became law. This will reduce the amounts deposited into the general revenue fund, bringing the ESF limit more in line with the original intent of the fund’s designers (reference HB 8 from 84R).

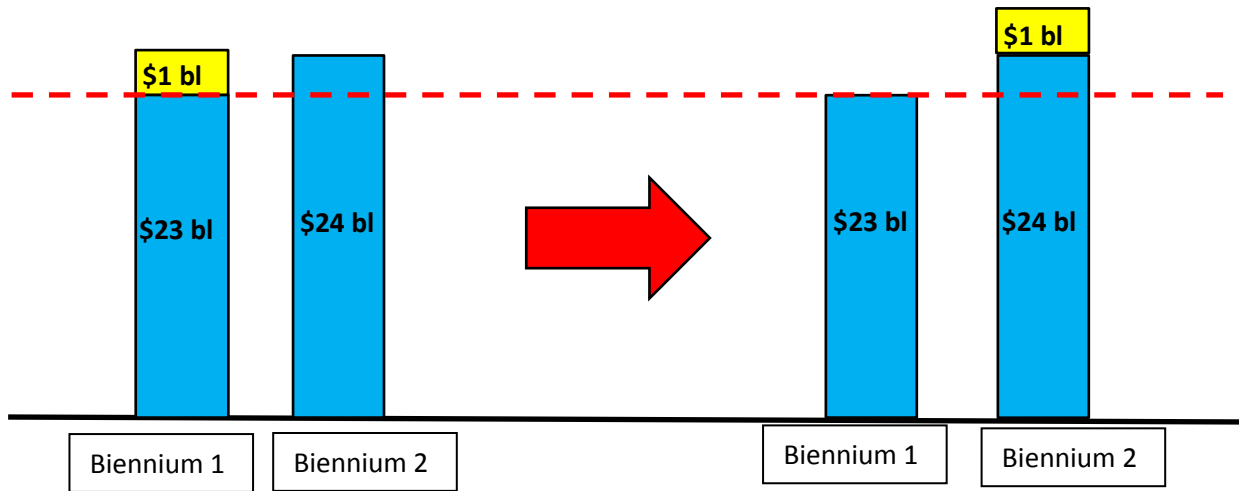
Testimony on the Use of One Time Funding Measures

Use of One-Time Funding. Examine the use of one-time funding and deferral measures employed by the Legislature in the state budget for the 2018-19 biennium, as well as any other factors that may contribute to a structural deficit. Explore strategies to ensure the state's ability to meet its ongoing fiscal obligations.

Dale Craymer
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One-Time Deferrals Cost Twice as Much As What You Save



Texas, as most all states, operates on a cash basis of accounting—meaning the Legislature may spend any unrestricted cash in the general revenue fund. This allows the Legislature to adopt timing measures that generate artificial revenue for certification or reduce cash obligations as a way of balancing the budget.

Texas has a long history of using various one-time funding shifts to either create one-time revenue increase or one-time spending reductions as a tool for balancing the appropriations bill.

A one-time deferral costs twice as much as what you save. In the above example, the state has a budget obligation that costs \$1 billion each month—or \$24 billion for a biennium. Facing a revenue shortfall of \$1 billion in Biennium 1, the state defers the final monthly payment, saving \$1 billion for purposes of certifying the budget. However, in Biennium 2, the state has the normal \$24 billion obligation, PLUS it must repay the \$1 billion payment deferred. The net result is a \$2 billion budget increase over Biennium 1 (the difference between 25 months of payments and 23 months of payments). Even if you redo the deferral in Biennium 2, a \$1 billion increase over Biennium 1 remains.

Examples of One-Time Funding Measures

General Revenue Enhancements

1983 68-R SB 985. Sales Tax Speed-Up. Permanently moved forward the dates for remitting sales taxes from the last day of the following month to the 20th day of the following month. This allowed an additional month of revenue to be processed in 1984.

1989 71-R HB 1356. Fuels tax transfer delay. Delayed the general revenue transfer of motor fuels taxes dedicated to the State Highway Fund (increasing net revenue in the general revenue fund at year's end).

1991 72-1: SB 3. Funds Consolidation: Abolished a number of special state funds, consolidating them into the General Revenue Fund as special accounts. The balances of these accounts create excess cash balances commonly referred to as GRD, or general revenue dedicated accounts.

2017 85-R: SB 1. Unclaimed Property. Comptroller sold accumulated securities, converting them into cash for deposit into general revenue.

2017 85-R: SB 1. Tax Amnesty: Comptroller was instructed to create a tax amnesty program, which will enhance collections of delinquent or unpaid taxes.

Reductions to Spending

1993 73-R: SB 81. ERS Pension Fund. Delayed transfer of state appropriations for the Employees Retirement Pension Fund.

1991 72-1: SB 3. TRS Pension Fund. Delayed transfer of state appropriations to the Teachers Retirement Fund.

2003 78-R HB 3459. Delayed the end-of-biennium August Foundation School Fund Payment until September of the succeeding biennium.

2017 85-1: HB 30. Delayed the end-of-biennium August Medicaid payment(s) until September of the succeeding biennium.

Other

Use of the **Economic Stabilization Fund** is a source of revenue that requires a specific appropriation each time it is tapped.

Though Texas is often blessed with substantial **surpluses of general revenue**, surpluses are technically one-time in nature.

Budget Shifts Between Biennial Budgets

(Figures revised from August 2017 TTARA Research Report)

Measure	Bill Number	2018-19 "Savings"	2020-21 "Cost"	Biennial Shift	Comments
Measures Used to Balance 2018-19 Budget					
Defer Transfer of Sales Tax Revenues Dedicated to the State Highway Fund (revised estimate)	85-R: SB 1 (Article VII, TxDoT Rider 42)	\$1.6 bl	\$1.6 bl	\$3.2 bl	Revised amounts based on certification revenue estimate; higher-than-expected sales tax revenue may reduce the amount of the deferral and shift
Funds/Accounts Consolidation	85-R: HB 3849	\$0.7 bl	\$0.0 bl	\$0.7 bl	Eliminated various dedications of funds within consolidated general revenue accounts
Accelerated Sale of Unclaimed Securities	85-R: SB 1 (Article IX, Rider 17.12)	\$0.5 bl	\$0.0 bl	\$0.5 bl	Comptroller sold unclaimed securities, converting them into cash for deposit into the General Revenue Fund
Delay Payment of August Medicaid Obligation (enacted in 2017 special session)	85-1: HB 30	\$0.6 bl	\$0.6 bl	\$1.2 bl	Bill allows for the deferral of August 2019 Medicaid payments.
Underfunded Medicaid in 2019	85-R: SB 1	\$2.0 bl	n.a.	\$2.0 bl	SB 1 appropriation does not provide funding for certain expected cost increases
New Items for 2020-21					
Motor Vehicle Sales Tax Dedication for Highways (revised estimate)	84-R: SJR 5	n.a.	\$0.1 bl		Current revenue trends suggest substantially lower number than 2015 fiscal note
Increase in the Sales Tax Transfer for Highways (revised estimate)	84-R: SJR 5		\$0.1 bl	\$0.1 bl	Amount based on 2018-19 certification revenue estimate; higher-than-expected sales tax revenue may eliminate any shift
Internet Tax Freedom Act (not included previously)	Federal law	n.a.	\$0.4 bl	\$0.4 bl	Federal law prohibits taxation of Internet access after June 30, 2019
Guaranteed Tuition Plan Shortfall (not included previously)	N.A.	n.a.	\$0.2 bl	\$0.2 bl	Tuition program is projected to be short of available funds



LEGISLATIVE BUDGET BOARD

INFORMATION TECHNOLOGY CYBERSECURITY CLOUD COMPUTING

PRESENTED TO HOUSE APPROPRIATIONS COMMITTEE

LEGISLATIVE BUDGET BOARD STAFF

APRIL 2018

Statement of Interim Charge

Monitor the ongoing implementation of Article IX, Sec. 9.13 of the General Appropriations Act and determine if state agencies are realizing cost savings and/or security enhancements in state operations related to cybersecurity, information technology, and cloud computing. Study trends in cloud computing and IT delivery services, and identify whether additional cost efficiencies, economies of scale, or IT modernization could be achieved.

Presentation Overview

- General Appropriations Act, (2018-19 Biennium) Article IX, Section 9.13
- Information Technology (Major Information Resources Projects)
- State Operations Related to Cybersecurity
- Cloud Computing Services

Article IX, Section 9.13

General Appropriations Act

- State agencies shall consider cloud computing service options, including any cost savings associated with purchasing those service options from a service provider or a statewide technology center established by DIR when making purchases for a major information resources projects.
- DIR is required to report to the Governor, Lieutenant Governor, and Speaker of the House of Representatives on the use of cloud computing service options by state agencies on or before November 15 of each even-numbered year.
- The report must include use cases that provide cost savings and benefits, including security enhancements. Agencies are to assist DIR in the creation of the report.

Information Technology (IT)

- In FY 2017, Department of Information Resources (DIR) provided a report to the Legislative Budget Board (LBB) on prioritization of state agencies' cybersecurity projects and projects to modernize or replace legacy systems.
- SB 1 85(R), Article IX, Section 9.10 requires the continuation of the report.
- DIR also is working with state agencies to introduce an Application Development Decision Framework. This is designed to guide agencies toward best practices in areas such as the identification of user needs, purchasing and development, deployment of cloud technologies, and staffing models.
- SB 532, 85 R requires DIR to collect certain information from state agencies on the status and condition of information technology infrastructure and report no later than November 15 of each even-numbered year to the Governor, Lieutenant Governor, Speaker of the House of Representatives, and staff of the LBB.

Major Information Resources Projects

- The Quality Assurance Team (QAT), which includes representatives of the Comptroller of Public Accounts (CPA), DIR, LBB, and the State Auditor's Office (advisory member), is charged with overseeing the development of major information resources projects.
- QAT is currently overseeing 79 major information resources projects with current estimated costs of \$1.5 billion over the life of the projects.
- SB 533, 85 R, requires a state agency assessment of proposed technical architecture for project to ensure agency is using industry accepted architecture standards in planning for implementation.
- With major information resource projects, some agencies are beginning to use an Agile methodology for major Information Technology projects. Agile uses incremental, iterative work sequences known as sprints.

State Operations for Cybersecurity Controls

- For FY 2018-19, DIR was appropriated \$21.5 million in All Funds to provide security policy, assurance, education, and awareness; and assist state entities in identifying security vulnerabilities.
- Additionally, DIR:
 - Provides a monthly online Cybersecurity Newsletter;
 - Hosts the Information Security Forum; and
 - Created the Texas Cybersecurity Strategic Plan for FYs 2018-2023 that establishes policy and governance security standards for agencies and institutions of higher education; which are closely aligned with the Federal Information Security Management Act.
- In addition to the \$21.5 million appropriation to DIR for on-going cybersecurity services, in FY 2018-19 other agencies received \$24.0 million for new cybersecurity projects and initiatives.

Cybersecurity in the State Budget

Cybersecurity costs are included in various strategies, projects, and programs in the budget, including:

- State Agency Staff (FTEs)
- Data Center Services (DCS)
- Centralized Accounting and Payroll/Personnel System (CAPPS)
- Capital Budgets
- Ongoing Maintenance (Daily Operations)
- Major Information Resources Projects

Cloud Computing Services

Three types of Cloud Computing Service Models:

- Infrastructure as a service
- Platform as a service
- Software as a service

Four types of Cloud Computing Deployment Models:

- Private Cloud
- Community Cloud
- Public Cloud
- Hybrid Cloud

Cloud Computing Services

- 76 percent of servers in the Data Center Services (DCS) program are using a private or public cloud service, allowing for improved operational efficiency, optimized delivery services and cost-savings.
- The DCS program has the ability to meet the growing technology needs for cloud services. The two state data centers offer storage, disaster recovery in fully managed facilities that include uninterrupted power source, networking, business continuity, and enhanced physical security.
- In 2015, DCS implemented hybrid cloud services with two major public cloud providers, Amazon Web Services (AWS) and Microsoft's Azure, for computing and storage.

Cloud Computing Services

- Cloud services offer alternatives to traditional IT delivery models, and are intended to reduce the burden of aging infrastructure and provide flexible, lower-cost, IT service delivery.
- In 2016, Department of State Health Services estimated a cost savings of 40 percent over three years using AWS. This estimate is self-reported by DSHS and has not been independently verified.
- CPA used a cloud-based commerce platform to replace legacy application architecture with TxSmartBuy2.0 (TSB2). Since the implementation of TSB2, CPA has reduced its maintenance costs to less than \$3.3 million annually, a 64 percent annual savings. These savings are not necessarily indicative of what other agencies may experience.
- SB 532, 85 R requires DIR to submit a report to the Legislature and Governor's Office no later than November 15 of each even-numbered year on the use of cloud computing service options by state agencies.



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Legislative Budget Board

www.lbb.state.tx.us

512.463.1200

DATA CENTER SERVICES



What is Texas Data Center Services Program?

The Texas Data Center Services program (DCS) allows governmental entities (customers) to outsource management of technology infrastructure and promote efficient, effective data center operations.

DCS includes two physical data centers, designed around government security and disaster recovery requirements, and flexible service tiers to meet differing needs and budgets. Joining the program allows customers to delegate data center management while increasing focus on delivering direct, mission-related value to their business users and clients.

The Need

Government entities face all of the technology challenges of their private sector counterparts, rising customer expectations, increasingly sophisticated security threats, and competition for skilled IT resources with additional requirements of being open, transparent, and auditable.

Compliance can be costly, and directing resources toward these vital tasks can draw attention away from developing creative business solutions that build additional value for state citizens.

The Solution

DCS was designed from the ground up with government security, budgetary and regulatory requirements in mind. The program delivers to customers a secure private, community cloud from two state-of-the-art facilities.

By leveraging DCS for server, mainframe and print/mail infrastructure, customers receive upgraded technology, robust security, and fully tested disaster recovery. Using an owner-operator governance model, customers retain control of strategic program direction while the service providers handle daily operations.

Program Benefits

As part of the Texas DCS program, customers benefit from the following program offerings:

- Uptime Institute Tier 2 Level Rated Environments in Austin and San Angelo
- Industry standard service levels
- Disaster recovery and testing in redundant dual data centers
- Full compliance with FBI Criminal Justice Information Services (CJIS) requirements, Texas State Auditor requirements, annual SSAE 16 audits, and biannual IRS audits
- Architectural design services and reference models to guide new server builds
- Control at executive through technical staff levels through governance committees
- Texas Department of Information Resources (DIR) contract management, oversight, and budgeting support

Not Your Typical Data Center

Hybrid Cloud Services (HCS) was introduced to the DCS program to provide customers with expanded cloud and semi self-management options, while meeting the business, security, and regulatory requirements of Texas state government. The services include Fully Managed and Semi-Managed options, as well as DCS private community cloud and public government cloud options.

Today, the State of Texas will be the first state to directly connect their two consolidated data centers, via highly secure network connectivity, to two of the world's most advanced cloud service providers. This results in a best-of-breed hybrid cloud model with ala carte unit rate options that are market priced.

Hybrid Cloud Options:

Some of the key features and benefits of this service are:

- Integrated DCS private community cloud with public government clouds via highly secure direct network connections
- Marketplace Portal: Includes service catalog for hybrid cloud services through the DCS private cloud and the public government cloud providers, enables shopping, selection and comparison of different build options, calculation of charges, review of shopping cart, and order submission
- Semi-managed and fully-managed infrastructure service options
- Automated cloud self-provisioning
- Next generation tools & infrastructure automation improving service delivery and infrastructure availability
- Agility, transparency, and control of customer IT infrastructure and financial spend
- Texas Administration Code (TAC) 202 security compliance

THE DEPARTMENT OF INFORMATION RESOURCES

The Texas Department of Information Resources provides contract management and oversight functions for DCS contracts. DIR provides statewide leadership and oversight for management of government information and communications technology. Our mission is to provide technology leadership, solutions, and value to Texas state government, education, and local government entities to enable and facilitate the fulfillment of their core missions.

For more information on Data Center Services, visit the DIR website: www.dir.texas.gov



TEXAS

Data Center Services

DCS Hybrid Cloud Services

Texas House Committee on Appropriations

April 18, 2018

Agenda

- DCS Hybrid Cloud Services Overview
- Public Government Cloud Characteristics
- DCS Community Cloud Characteristics
- Data Protection (Back Up & Recovery)
- Ordering Services

Hybrid Cloud Services Overview



Hybrid Cloud Services Charter



Vision

Modernize the DCS program to an **as-a-service model** leveraging automation, proven solutions (buy vs. build), and current resources to **remain relevant** to current customers and **fuel growth** with new customers.



Intended Outcomes

- Self-service, à la carte cloud offerings
- Hybrid delivery model – cloud and full service
- Financial structure that creates value for all parties

Hybrid Cloud Services: What's New

- **Integrated DCS private community cloud with public government cloud** options in the consolidated data centers
- **Semi-managed & fully-managed** service options
- **Automated cloud self-provisioning**
- **Next generation tools & infrastructure** automation improving service delivery and infrastructure availability
- **Agility, transparency, and control** of customer IT infrastructure and financial spend
- **Financial restructure** and vendor investment to achieve the above objectives

What is “Hybrid Cloud?”

- Public Cloud - IT infrastructure technology accessed over a wide-area network
- DCS Community Cloud - is a private cloud specifically built and shared only by DCS Customers
- Hybrid Cloud - is the ability to have **services** in both public and private cloud technologies
 - “Private” means owned and used by one customer (e.g., DCS today)
 - “Public” means rented technology shared by multiple customers (e.g., Amazon, Azure)
- DCS Hybrid Cloud - means applications and data residing in state’s consolidated data centers connect directly with applications and data residing in government public cloud.

Public Government Cloud Characteristics



Public Government Cloud Workload Characteristics

Recommended Characteristics for Workload Placed in Public Government Cloud Platform

- Mobility Access data from anywhere
 - Flexibility Spin up/spin down resource; using only as needed
 - Scalability On demand scalable capacity is needed
 - Elasticity Highly elastic
 - Performance Not performance critical
 - Latency Moderate to high latency tolerance
 - Application Not transactional
- Currency N/N-1

Public Government Cloud Workload Characteristics

Recommended Characteristics for Workload Placed in Public Government Cloud Platform

- Data
 - Occasional to infrequent access
 - Write-once, read occasionally
- Storage
 - Lower cost/performance
 - Active usage which is read and write transactional
 - Integrated with workload in Public Government cloud
 - Not Integrated with workload in CDCs
- Integration
 - No workload integration with CDCs or
 - High degree of latency of CDC integration

Public Government Cloud Workload Examples

- Sandbox environments
- Short-term project initiatives:
 - Application/Refresh remediation
 - Application upgrade initiatives
 - User acceptance testing
 - User Training
 - Development and prototyping environments
 - Test environments
- PaaS and SaaS
 - Already in the Public Government Cloud Marketplace
 - Predefined costs and solutions
- Special purpose environments:
 - A web application environment with cyclical workload demand requirements
 - with approved CDC environment interaction
 - An engineering or Business Intelligence environment performing data analysis workloads with varying workload demands
 - with approved CDC environment interaction
 - Emerging application environments with services well integrated with public cloud solutions

DCS Community Cloud Characteristics



DCS Community Cloud Workload Characteristics

Recommended Characteristics for Workload Placed in DCS Private Community Cloud

- Latency Low latency tolerance
- Performance Critical performance
- Data Frequent access
Regulated Classification
- Storage Active usage
Read/write
Integrated with workload in CDCs
Not integrated with workload in Public Government Cloud
- Security Regulated and confidential data and workloads

DCS Community Cloud Workload Characteristics

Recommended Characteristics for Workload Placed in DCS Private Community Cloud

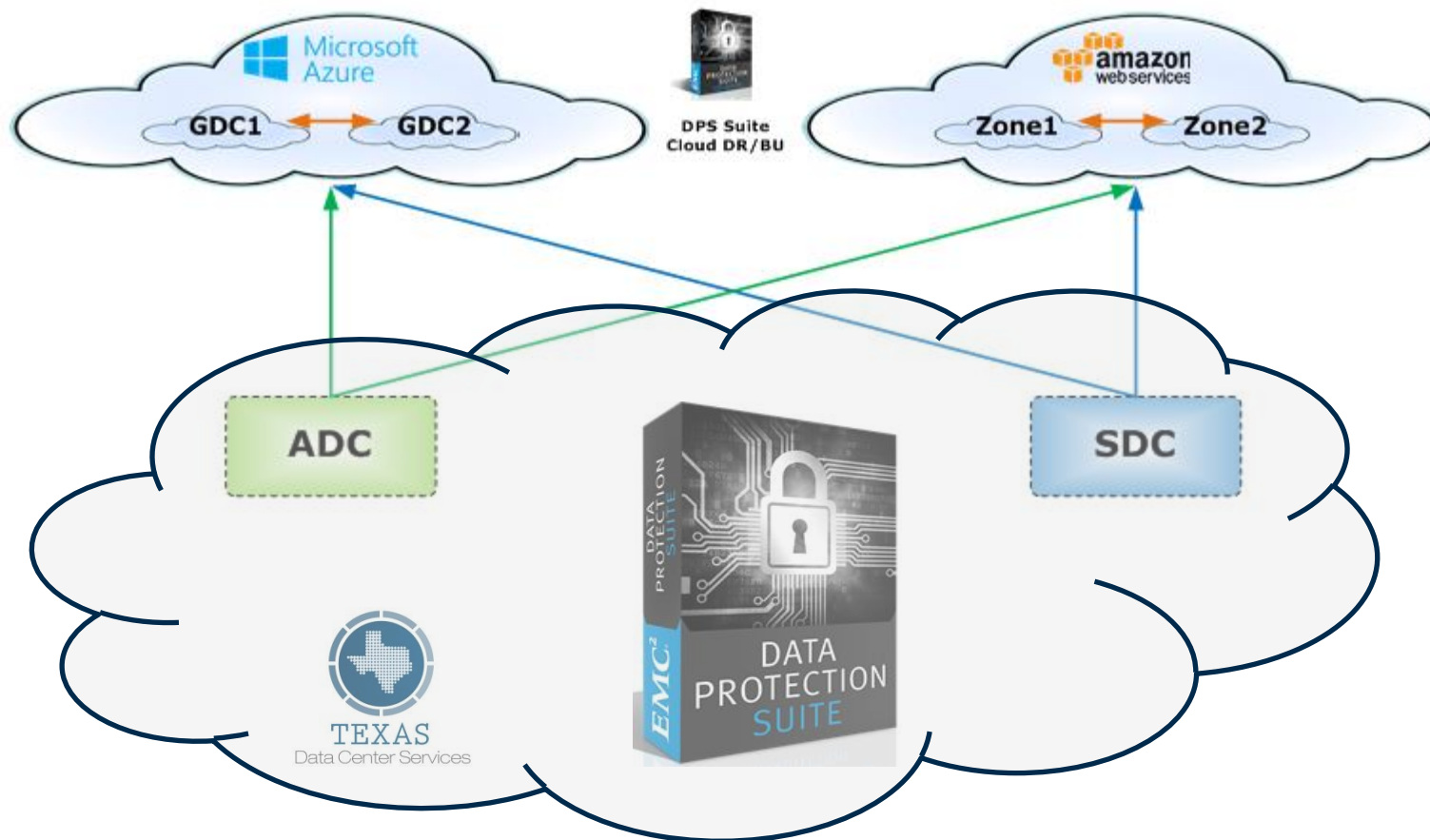
- Application Transactional
Currency N/N-1,2,3
- Mobility Lower need to access data from anywhere
- Flexibility Continual use, production applications
- Scalability Limited scalable capacity
- Elasticity Limited elasticity

DCS Community Cloud Workload Examples

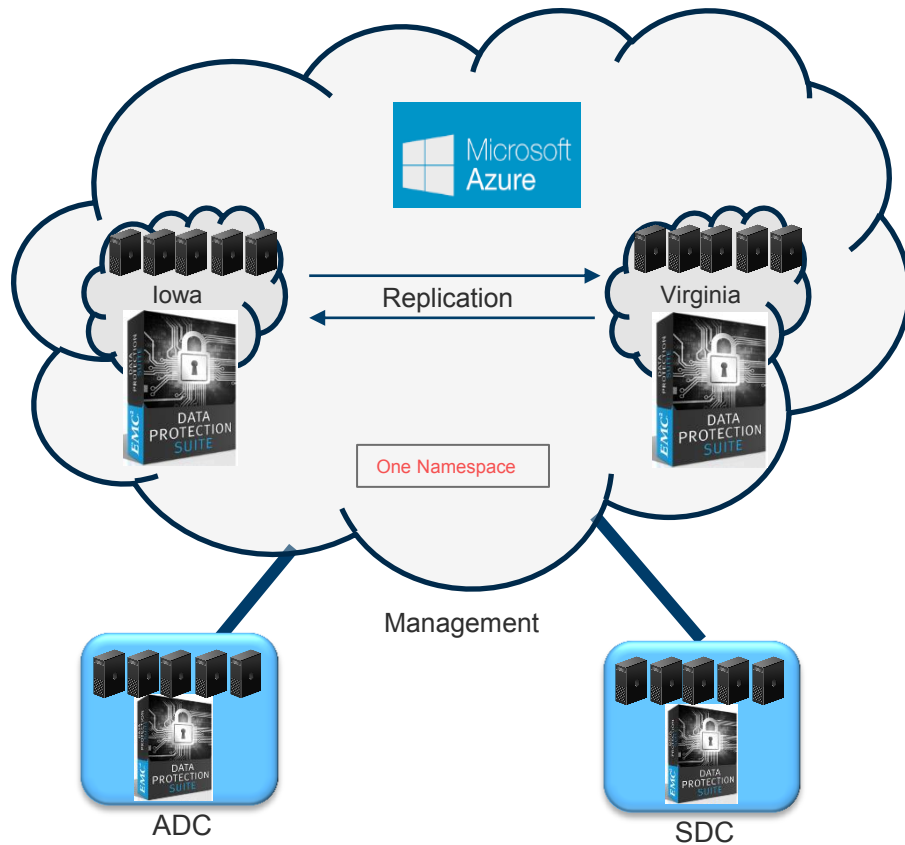
- Mission critical production applications
- Applications tightly coupled with other applications in the CDCs
- Medium and large workloads
- Higher speed storage directly attached to an on-prem server
- Long-term (24X7X365) ongoing operations
- Regulated and confidential data sets
- Legacy hardware
- N/N-1, N-2, N-3 and older software

A hand is shown pointing at a digital interface. The interface features a map of Texas in the center, surrounded by various technology icons such as a smartphone, a cloud, a speech bubble, a document, and a network signal. The background is a dark blue gradient with a subtle pattern of binary code (0s and 1s).

ATOS Hybrid Cloud Backup Solution Using EMC's Data Protection Suite (DPS)



ATOS Hybrid Cloud Backup Solution Using EMC's Data Protection Suite



Ordering Services



DIR Marketplace

Hybrid cloud services are ordered through the DIR Marketplace

- Linked to DCS Portal through Single Sign On
- One Stop Shop for common cloud services
- Enables customers to
 - Review cloud service options
 - Compare prices
 - Fill a shopping cart with selections
 - See total estimated charges
 - Buy the shopping cart for quick provisioning with direct link to ITSM
- If regulated data is involved, Marketplace will direct user to complete traditional service request so appropriate approvals can be documented

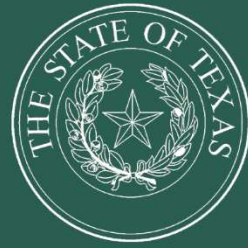
HCS Functionality and Services for September Release

New Functionality

- Web landing page via SSO for new Cloud services, with improved user experience
- Estimated pricing when services are selected
- Compare and procure up to 4 Servers in one request
- Copy previous requests and copy to create a similar request
- Select existing HCS assets and make changes (e.g., add more storage)
- View all requests or user-specific requests for a given DCS Customer

Included Services

- Add new Server (Internal and external Cloud)
- Modify existing server
- Decommission server
- Add new EFS
- Modify EFS
- Decommission EFS
- Add new storage
- Modify storage



LEGISLATIVE BUDGET BOARD

Contract Reporting and Oversight

PRESENTED TO HOUSE APPROPRIATIONS COMMITTEE

LEGISLATIVE BUDGET BOARD STAFF

APRIL 2018

STATEMENT OF INTERIM CHARGE

Monitor the ongoing implementation of S.B. 20 (84R), S.B. 533 (85R), and S.B. 255 (85R). Study the processes by which state agencies award, execute, manage, and monitor state contracts, and make recommendations on whether any changes are necessary to safeguard the best interest of the public and state. Evaluate measures utilized to determine vendor performance, and make recommendations on how to improve vendor selection and performance. When reviewing the Health and Human Services Commission's (HHSC) managed care contracts, determine if HHSC has adequate data, staff, and processes to provide appropriately rigorous contract oversight, including but not limited to the use of outcome metrics. Consider whether HHSC properly enforces contractual sanctions when managed care organizations (MCOs) are out of compliance, as well as how HHSC uses Medicaid participants' complaints regarding access to care to improve quality.

PRESENTATION OVERVIEW

- SB 20 (84R)
 - Vendor Performance Tracking
 - Contract Reporting
- SB 533 (85R)
- SB 255 (85R)
- Article IX Reporting Requirements and Oversight

SENATE BILL 20 (84R)

Senate Bill 20 (84R) modified various agency contract administration requirements, including:

- Increased record retention for contracts to seven years;
- Required additional information on contracts be included in the state accounting system;
- Established bid requirements and caps for DIR cooperative contracts;
- Required agencies use the CPA Vendor Performance Tracking System; and
- Required agencies post contracts to their website.

SB 20: VENDOR PERFORMANCE TRACKING

SB 20 requires agencies to report vendor performance to the Comptroller's Vendor Performance Tracking System (VPTS) for purchases over \$25,000.

Interagency agreements are exempt.

- The purpose of the Vendor Performance Tracking System is to:
 - Identify vendors that have exceptional performance;
 - Aid purchasers in making a best-value determination based on vendor past performance;
 - Protect the state from vendors with unethical business practices; and
 - Provide performance grades (A-F) in five measurable categories for the Centralized Master Bidders List (CMBL) vendors.

VENDOR PERFORMANCE TRACKING SYSTEM

- Updated VPTS requirements went into effect starting in FY 2016
- Usage of the VPTS in FY 2016 and FY 2017 has been low.

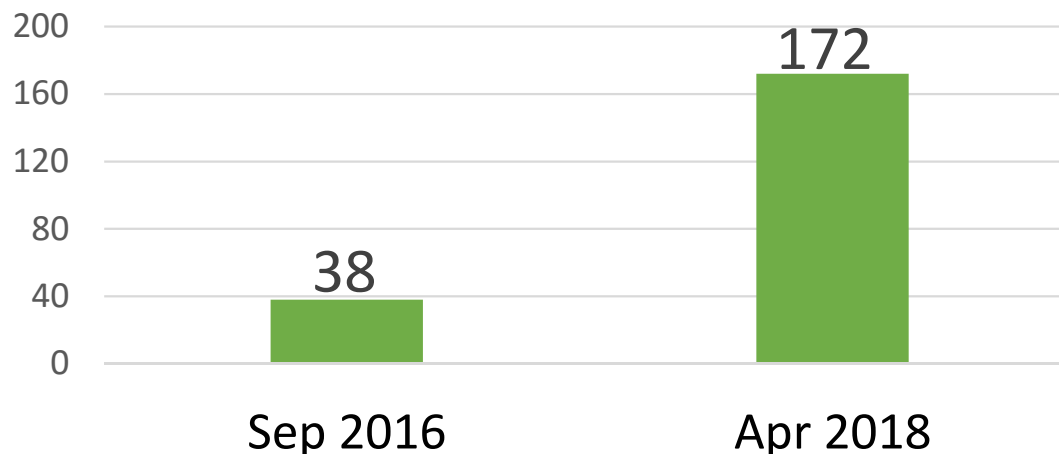
Contracts Reported to LBB Subject to VPTS Requirements	% of Those Contracts Where Vendor has VPTS Entry	Value of Eligible Contracts in LBB Database w/o VPTS entry
37,316	14.8%	\$179.3B

- LBB and Comptroller staff are working together to monitor and analyze the VPTS and will be surveying procurement personnel on its usage.

SENATE BILL 533 (85R)

- SB 20 (84R) required agencies to post every contract awarded to a private vendor on their agency website, starting in September 2015.
- Effective September 2017, SB 533 (85R) amended the SB 20 requirement by exempting agencies from posting contracts to their own website if they submitted the contract to the LBB Contracts Database.

State Entities Meeting SB 20 Contract Posting Requirements



Out of 234 state entities, some without reportable contracts

- HHSC, TXDOT, and IHEs are statutorily exempt from uploading contract documents when submitting to the LBB Contracts Database and therefore are not required to post contract documents.

SENATE BILL 255 (85R)

SB 255 requires a state agency that spends more than \$5,000 in a state fiscal year for a training or education program for any individual administrator or employee to submit an annual report to the LBB detailing:

- a list of the administrators and employees participating in a training or education program;
- the amount spent on each administrator or employee; and
- the certification earned by each administrator or employee through the training or education program.

The first report is due August 31, 2018.

CONTRACT REPORTING

Statute and the General Appropriations Act (GAA) require agencies and institutions of higher education to report to the Contracts Database:

TYPE OF CONTRACT	VALUE THRESHOLD	REPORTING TIMEFRAME	LOCATION
Professional or Consulting Services	> \$14,000	10 days after award	2254.006, 2254.0301 Government Code
Construction	> \$14,000	10 days after award	2166.2551 Government Code
Major Information Systems	> \$100,000	10 days after award	2054.008 Government Code
All	> \$50,000	<u>30 days after award</u>	GAA Article IX, Sec 7.04
Non-Competitive/Sole Source	> \$1,000,000	<u>Prior to first payment, but no later than 30 days after award</u>	GAA Article IX, Sec 7.12
Emergency	> \$1,000,000	48 hours after payment	GAA Article IX, Sec 7.12
All	> \$10,000,000	<u>Prior to first payment, but no later than 30 days after award</u>	GAA Article IX, Sec 7.12

SOURCE: Legislative Budget Board.

Note: Changes made by the 85th Legislature are underlined and are effective September 1, 2017.

Note: The Government Code requirements are subject to numerous exceptions and exemptions. However, the GAA provisions apply to all entities receiving appropriations, regardless of method of finance or source of funds used for the contract.

CONTRACT REPORTING

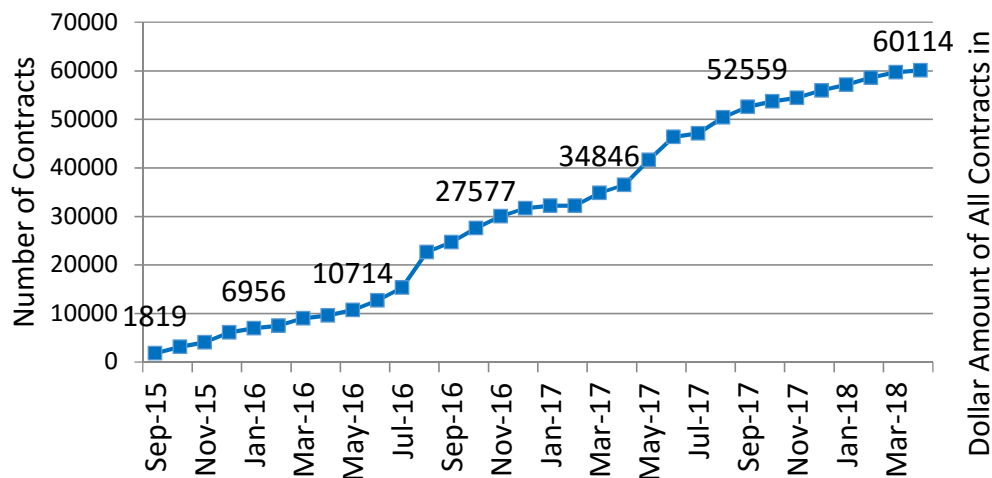
Contract Reporting Riders 2018-19 GAA, Article IX, Sections 7.04 and 7.12

As of April 2018:

- 172 reporting entities
- Over 60,000 contracts submitted
- \$260.3 billion in contracts reported

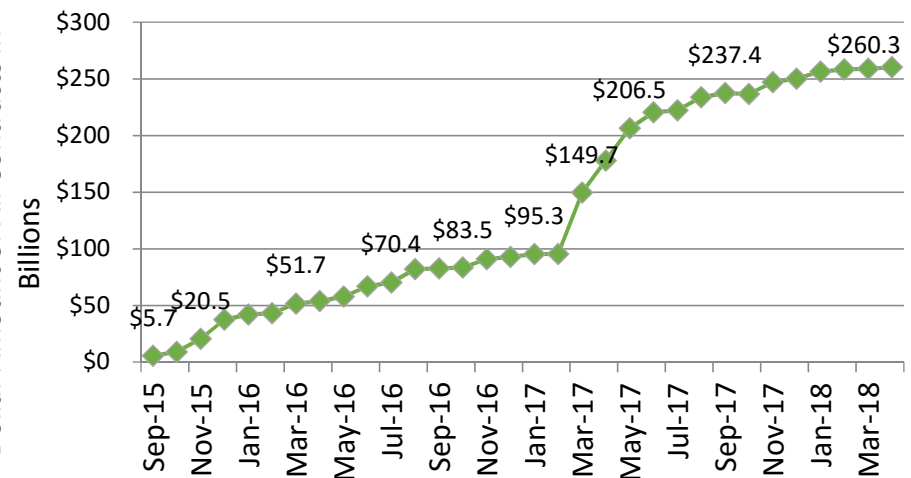
Contracts span multiple fiscal years, and some may have been completed since they were reported.

Number of Contracts Reported to LBB Database



April 18, 2018

Value of Contracts Reported to LBB Database



LEGISLATIVE BUDGET BOARD ID: ####

10

ATTESTATION LETTERS

- Art IX, Sec. 7.12 of the GAA requires a letter, signed by the executive commissioner or designee, for each procurement over \$10.0 million and non-competitive procurement over \$1.0 million attesting that:
 1. The procurement complied with all applicable statutes, rules, and policies;
 2. The agency has an effective process to verify vendor performance and deliverables;
 3. The good or services being procured are necessary; and
 4. There is a continuing duty to report any changes to the information provided.

CONTRACT REPORTING

10% Amendment Rider 2018-19 GAA, Article IX, Section 7.04(g)(h)

- Between September and November of 2017, 61 agencies and institutions of higher education reported 1,424 amendments to the Contracts Database that met the value threshold for Section 7.04(g)(h). **Together, the 1,424 amendments increased their initial contracts' values by over \$18 billion, from all funding sources.**
- 385 of these 1,424 amendments (27%) changed the original contract's value by \$1 million or more.**

FIGURE 1: AMENDMENTS REPORTED IN Q1 2018 BY GAA ARTICLE

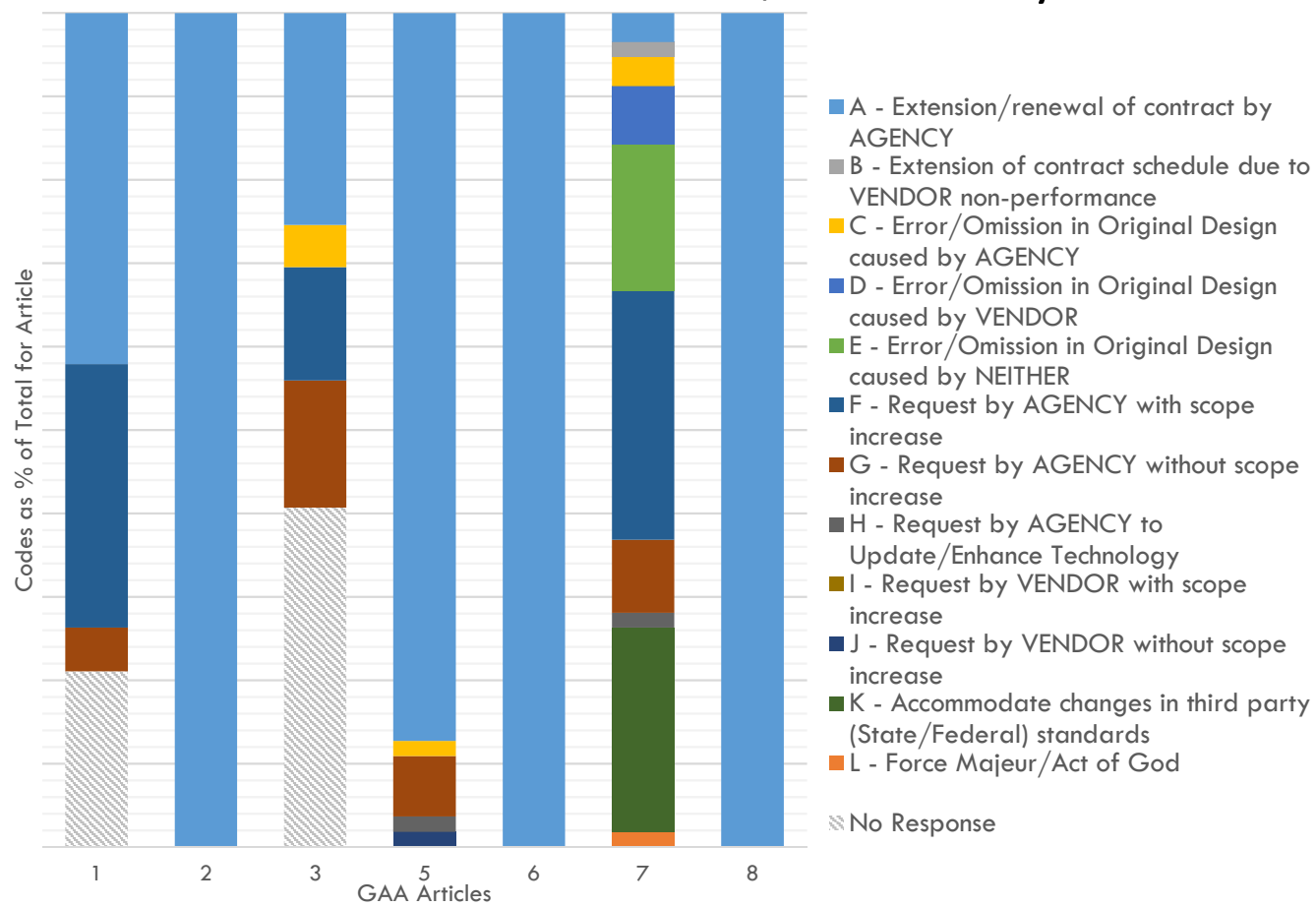
	Number of Amendments	\$ Increase (Millions)
Article I: General Government	99	\$306.5
Article II: Health and Human Services	402	\$16,337.2
Article III: Education	420	\$600.7
Article IV: Judiciary	4	\$0.2
Article V: Public Safety	174	\$413.1
Article VI: Natural Resources	38	\$14.1
Article VII: Economic Development	278	\$339.9
Article VIII: Regulatory	9	\$4.5
TOTALS	1,424	\$18,016.2

Source: Legislative Budget Board

CONTRACT REPORTING

10% Amendment Rider

Reasons For Amendments Over \$1 Million By GAA Article



CONTRACT OVERSIGHT

LBB Staff Contract Reviews

2018-19 GAA, Article IX, Sections 7.04(f) and 7.12(f)

- LBB staff are authorized to conduct reviews of contracts to ensure compliance with best practices from:
 - The State of Texas Contract Management Guide;
 - The State of Texas Procurement Manual; and
 - Any applicable statutes, rules, policies, and procedures.
- The Director of LBB may provide confidential written notification to the Comptroller, the Governor, and/or the Legislative Budget Board of any unresolved violations identified.
- The written notification may include enforcement mechanisms based on existing legislative authorities, including:
 - Enhanced monitoring by LBB staff;
 - SAO audit;
 - Required consultation with Quality Assurance Team or the Contract Advisory Team; and
 - Recommendation to cancel the contract.

CONTRACT OVERSIGHT

Contract Cost Containment Rider 2018-19 GAA, Article IX, Section 17.10

- “It is the intent of the Legislature that all agencies and institutions of higher education find savings in contracted goods and services”
- Appropriations across state agencies were reduced by \$34 million, and strategies were identified to assist agencies in achieving those savings.
- Progress reports are due to the Legislature and the Governor by:
 - September 30, 2018 for fiscal year 2018; and
 - August 31, 2019 for the 2018-19 biennium.

CONTRACT OVERSIGHT

Quality Assurance Team Contract Reviews 2018-19 GAA, Article IX, Section 9.01 (d)

- Agencies are required to submit Major Information Resource Project contracts valued over \$10 million to QAT for review and approval.
- Submitted contracts must be the final draft version, and be signed by the vendor but not the agency.
- Contracts will not be valid without QAT's written approval.



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512.463.1200

House Appropriations Committee

The Honorable John Zerwas, Chair

Robert Wood

Associate Deputy Comptroller for Operations and Support

Texas Comptroller of Public Accounts

April 18th, 2018

Catalyst for Legislative Action

- SB 20 (84R), SB 255 (85R), and SB 533 (85R) were responses to concerns regarding:
 - No-bid contracts
 - Ethics/Conflicts of Interest
 - Transparency
 - Need to improve training

SB 20 - Centralized Purchasing Study

Select Findings and Observations:

- Further consolidation would yield minimal benefits in relation to cost
- There was a need for basic-level training
- Purchasing rules are complex; there are many statutory exemptions and exceptions to contracting requirements

Three Pillars of Contract Success

- Training
- Process (Including Internal Oversight)
- Oversight/Audit

Training

- Statute changes allow training to adjust quickly to emerging issues, while reducing costs to agencies
 - SPD changed certification requirements to ensure anyone doing true contract development is properly trained and certified
- New SPD training team dedicated to curriculum development & policy research
 - SPD restructured training, revised curriculum, and brought all training in-house

Process -Ethics-

- State now requires:
 - Increased disclosure of conflicts of interest
 - Posting of contracts to agency websites
 - Increased reporting requirements for contracts exceeding specific dollar amounts
 - Revolving door provision
- SPD mandated 1-hour ethics training for re-certification

Process

-Vendor Relations & Reporting-

- SPD updated Vendor Performance Tracking System (VPTS) to improve vendor performance reporting
- Uncertainty in vendor-agency communication following 84th session
 - SPD created procurement advisory group to facilitate communication
 - SPD, along with other agencies, issued vendor communication policies

Oversight

- Further integrated oversight of statewide contracts
 - CPA, DIR, LBB, and SAO collaborating extensively in areas of solicitation review, major information resources project review, training, proper use of appropriations in contracting
 - Improved communication between Quality Assurance Team and Contract Advisory Team
- Primary responsibility to focus on procurement risk

Oversight (cont.)

- Training, guidance, and interagency oversight collaboration has set the foundation for continuous improvement
 - The model allows for the pooling of agency oversight resources to address issues as they come up
 - Improved cooperation and training allows for the ability to adjust oversight and training in response to issues & trends in Texas public procurement

Implementation Challenges

- **Training** - Ongoing challenges with the education level of purchasers across agencies
- **Process** - Agency focus on overlapping and complex rules and regulations leaves less time for consideration of risk and best value
- **Oversight** - Interagency Oversight teams experience ongoing challenges helping agencies re-set their focus on risk in a environment with varying thresholds, exemptions, and conditional requirements

Questions?

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Texas Comptroller of Public Accounts

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(512) 463-3973



Presentation to the House Appropriations Committee

Charles Smith

Executive Commissioner

Ron Pigott

**Deputy Executive
Commissioner for Procurement
& Contracting Services**



TEXAS
Health and Human
Services

April 18, 2018



TEXAS
Health and Human
Services

Presentation Outline

- SAO Audit of TxEVER Contract
- Overview of CHIP RSA RFP
- Procurement Process
- New Policies and Procedures
- Next Steps

SAO Audit of TxEVER Contract

- On June 1, 2016, the Health and Human Services Commission (HHSC) and the Department of State Health Services (DSHS) awarded Genesis Systems, Inc. a contract for the development and maintenance of the Texas Electronic Vital Events Registrar (TxEVER), a comprehensive vital event registration system.
- A recent audit of the contract by the State Auditor's Office (SAO) identified weaknesses in HHSC and DSHS's contract procurement and formation processes.



SAO audit findings

- Final evaluation scores of vendor proposals were not calculated accurately.
- HHSC did not verify vendors' reported qualifications as specified in the solicitation.
- DSHS did not obtain the required exception from the Governor and the Department of Information Resources that would allow the vendor to host TxEVER, instead of the Statewide Data Center Services Program.
- HHSC did not accurately report the initial contract value to the Legislative Budget Board.



Management response

PCS implemented new policies and procedures for the solicitation evaluation process, which included adopting a standard evaluation tool for all procurements and implementing a required secondary review of the tool, by the appropriate PCS manager, before and after the evaluations are completed. These new policies and procedures were implemented on December 19, 2016. However, since this audit and during the management response timeline, it has become apparent that the new policies and procedures were not properly implemented by all staff. This failure is being addressed.

Management response submitted on April 9, 2018.



HHSC response to SAO Audit

- HHSC agrees with the SAO's findings and is working to ensure secondary review and verification of evaluation tools.
- HHSC will review and ensure that requirements for checking vendor qualifications in future solicitations are in line with statute.
- In 2016, HHSC issued a written directive to purchasing staff outlining a new requirement that, prior to commencing a major information system procurement, the buyer is required to obtain a copy of the Data Center Services waiver request and approved waiver.
- Contract reporting for the TxEVER contract and amendment has been corrected in the LBB contract reporting system. Contract reporting will be more accurate because of new systems implemented on September 5, 2017.





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Overview of CHIP RFP

- On January 5, 2017, HHSC posted the CHIP Request for Proposal (RFP) for the Hidalgo and Rural Service Areas (RSA).
- The RFP was intended to serve as a 17-month bridge from September 1, 2018, to December 31, 2019.
- A new statewide RFP was posted April 6, 2018, and will take effect January 1, 2020.



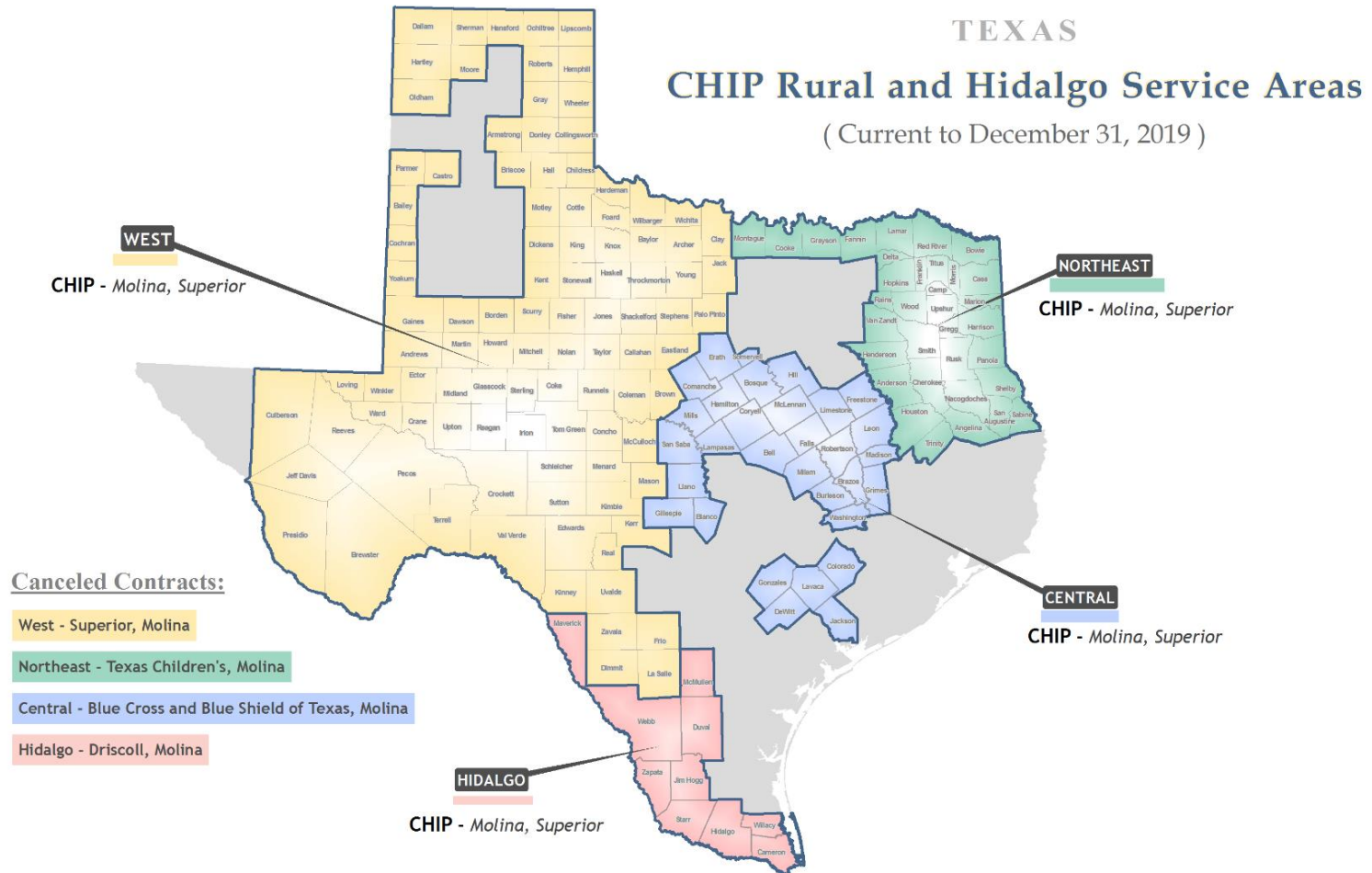
TEXAS
Health and Human
Services

CHIP RSA RFP

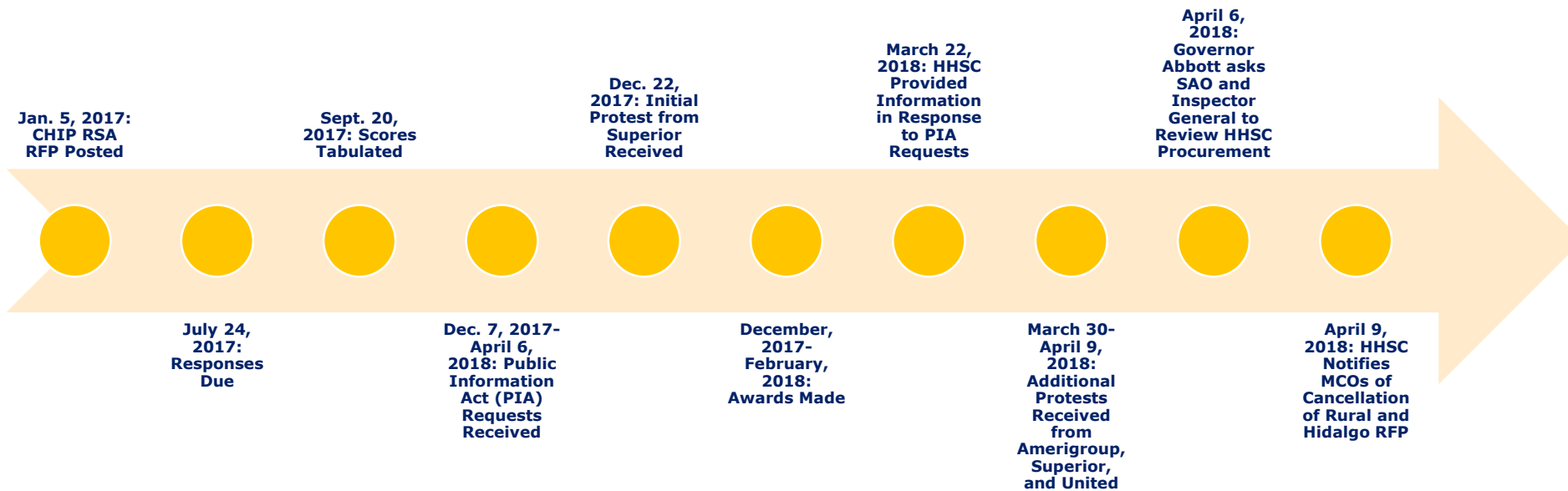
Cancelling the contracts will have no impact on delivery of service to Texas children, as existing contracts will be extended through December 31, 2019.

- Staff used an evaluation tool for the CHIP Hidalgo and RSA RFP that contained formula errors.
- As a result, scoring errors occurred, and evaluation scores were not calculated correctly.
- After contracts were signed, HHSC received protests from MCOs calling attention to the scoring errors.
- In response, HHSC initiated an analysis of the procurement and subsequently cancelled the executed contracts.
- Cancelled contracts (estimated value \$580M total) were short-term contracts, set to begin Sept. 1, 2018, and run through Dec. 31, 2019.

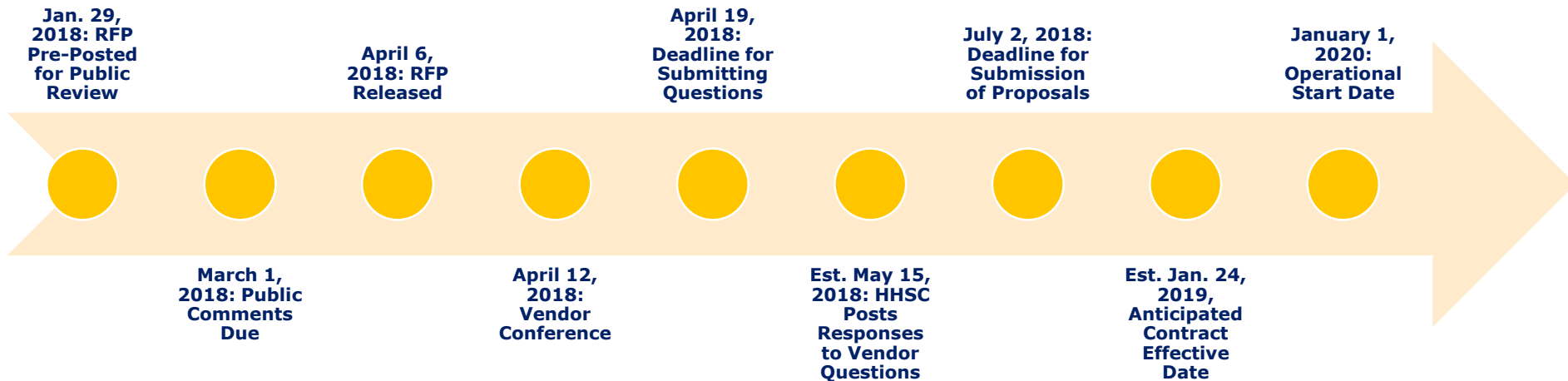
CHIP Hidalgo and Rural Service Areas



Timeline of CHIP RSA Contracts



Timeline of CHIP Statewide RFP



Staff Procurement Roles

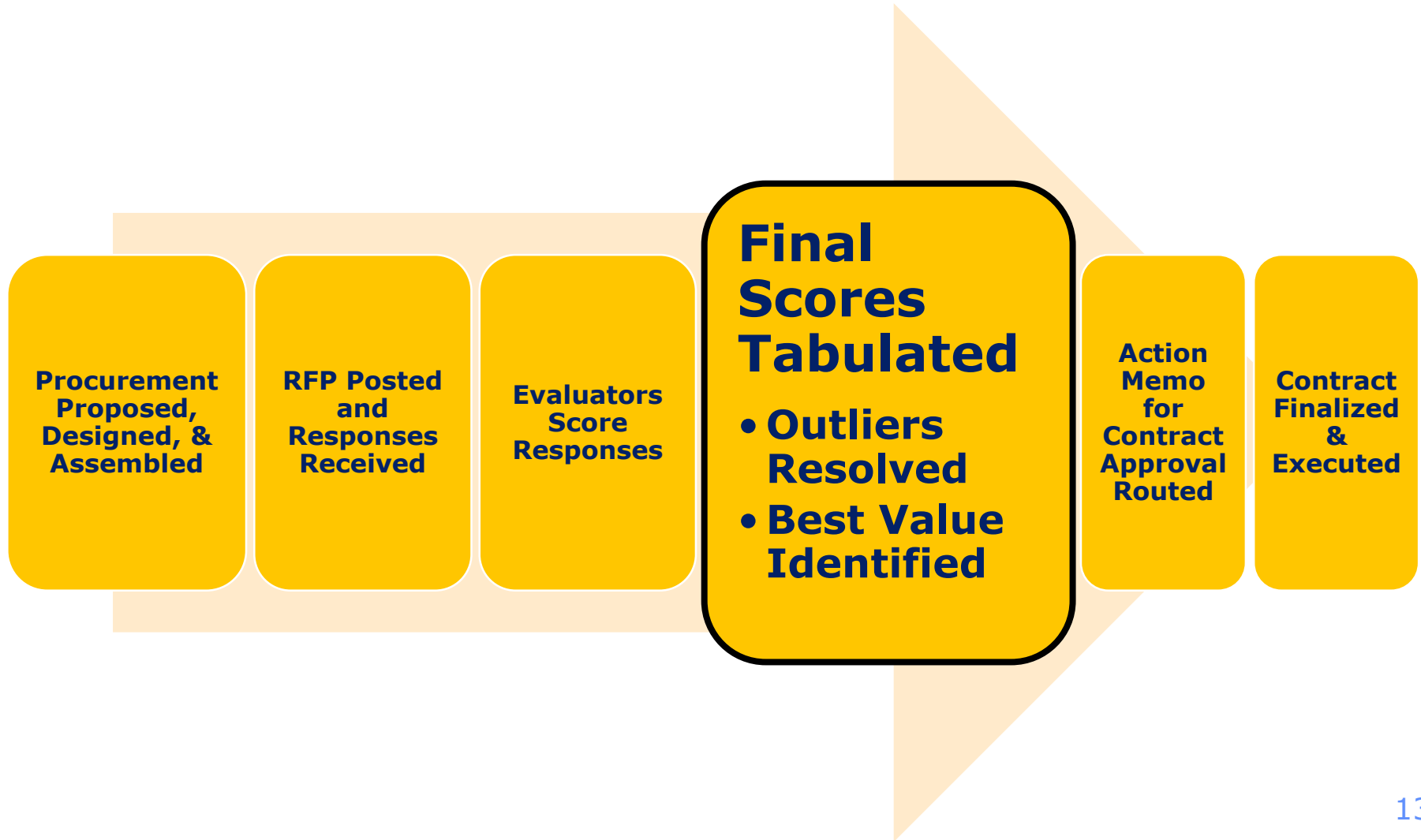
Evaluators: HHSC Program Staff who score proposals on established criteria.

Purchasers: HHSC Procurement and Contracting Services (PCS) staff who tabulate final scores to identify “Best Value” for the program.

Managers and Supervisors: PCS manager and supervisor validate purchaser’s conclusions.



Procurement Process



What should have happened

- The errors occurred during the evaluation stage of the procurement process when final scores are tabulated and “Best Value” is identified.
- The HHSC purchaser should have
 - used the correct version of the evaluation tool,
 - checked the scores, and
 - resolved any inconsistencies or outliers in scoring.
- The purchaser’s supervisor and manager should have
 - ensured the purchaser was using the correct tool properly, and
 - reviewed the purchaser’s work.

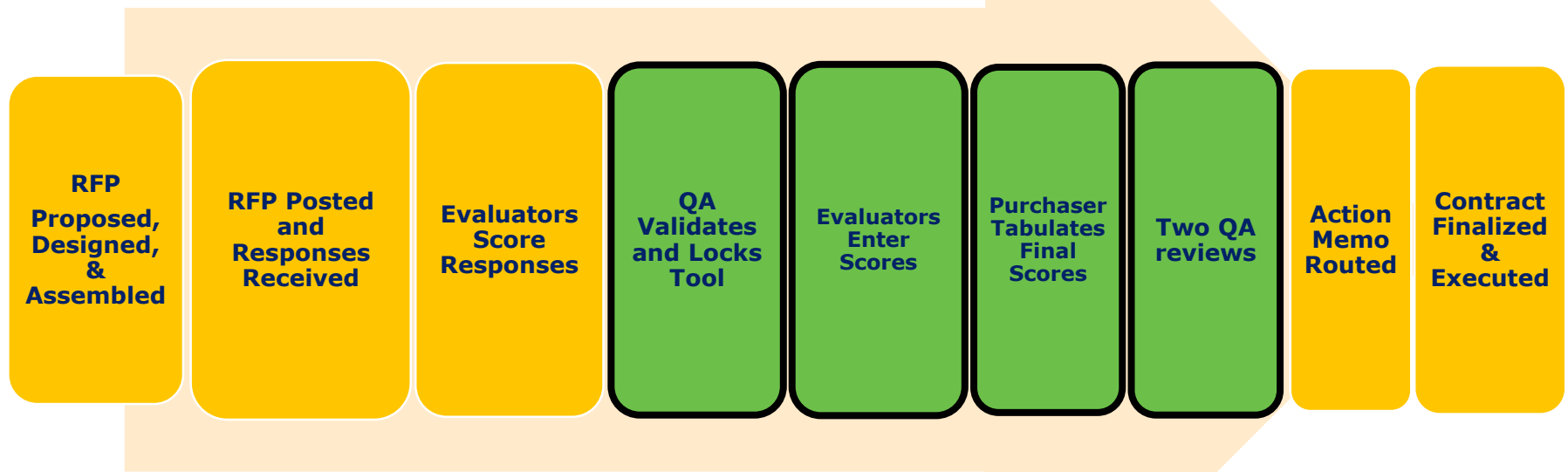


New Policies and Procedures

- An approved, standardized tool is in place, but it was not used for the CHIP RSA RFP.
- To ensure correct processes going forward, the tool is now owned and locked by HHSC **Quality Assurance (QA)**.
- Under the new process:
 - Purchaser sends the evaluation criteria to QA.
 - QA enters the criteria into the approved tool.
 - QA validates that the tool is working correctly and locks it.
 - Evaluators enter their scores on their individual sheets.
 - Purchaser compiles the scores into the final score tabulation and resolves outliers.
 - **Two separate QA reviewers** review the evaluation tool and scores to ensure that all calculations are correct and outliers have been addressed.



New Steps in Procurement Process



Next Steps

- ✓ HHSC notified MCOs that the agency will extend current contracts for the Rural and Hidalgo Service Areas.
- ✓ On April 6, HHSC posted a new, statewide RFP that will include these services and begin Jan. 1, 2020.
- IN PROGRESS HHSC Internal Audit is reviewing contracting processes and evaluation tools.
- IN PROGRESS Per the request of the governor, the State Auditor's Office (SAO) and the Inspector General (IG) are conducting a review of HHSC contracting.
- IN PROGRESS HHSC will continue to implement necessary improvements identified internally, as well as by SAO, IG, MCOs, or the legislature.



The background of the slide features a large, faint seal of the State of Texas on the left side. The seal is circular with a five-pointed star in the center, surrounded by a wreath. The words "STATE OF TEXAS" are inscribed around the perimeter of the seal.

Strengthening Program Integrity in Managed Care

Sylvia Hernandez Kauffman

Inspector General

House Appropriations Committee

April 18, 2018



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OIG Priorities



- Prevention
- Medicaid Contract Oversight
- Strengthen Relationships
- Rigor and Professionalism



TEXAS
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Managed Care Focused Activities

Primary Tools

- Audits
- Reviews
- Inspections
- Investigations

Other Tools

- Program Integrity SMEs
- Data Analytics
- Provider Enrollment



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Audits

Informational Reports

- Utilization Management
- Special Investigative Units
- Speech Therapy
- Pharmacy Benefit Managers

Performance Audits

- Special Investigative Units
- Utilization Management
- Delivery Supplemental Payments

Information Technology Audits

- Information Technology Security



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Reviews

Nursing Facility Utilization Reviews

- Assess if nursing facility payments are appropriate for residents' level of care.
- Only entity performing nursing facility minimum dataset utilization reviews.



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Inspections

Managed Care Focused Inspections in Progress

- Electronic Visit Verification
- Medicaid Payments for Deceased Clients
- Clients with Multiple Medicaid Identification Numbers
- Managed Care Duplicate Capitated Rate Payments



TEXAS
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Investigations

Managed Care Referrals

- Managed care organizations are required to notify the OIG of all fraud and abuse cases. For cases over \$100,000, the OIG determines if it will pursue the case or refer it back to the MCO.

State Fiscal Year 2018	Number of MCO Referrals
Quarter 1	56
Quarter 2	59
Total	115

- The OIG also identifies managed care cases through referrals, complaints or data analytics.
- House Bill 2379, 85th Legislature, 2017 requires managed care organizations to share 50 percent of their recoveries with the OIG for the cases they initiated or work on jointly with the OIG.



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Other Activities

Program Integrity Subject Matter Experts

- Procurements
- Contract Language Recommendations
- Clinical Expertise

Data Analytics

- Reviews and Analyzes Encounters
- Identifies Outliers

Provider Enrollment

- Medicaid and CHIP provider program integrity screenings



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Strengthened Relationships

Increased Engagement

- Texas Fraud Prevention Partnership
 - Collaboration between the OIG, select managed care organizations, Medicaid CHIP Services and the Office of the Attorney General's Medicaid Fraud Control Unit.
- Special Investigative Unit Meetings
 - Quarterly meetings are held between the OIG and the managed care organizations' special investigative unit staff.
- Office of the Attorney General's Medicaid Fraud Control Unit
- Managed Care Organization Leadership Meetings
 - Participate in Medicaid CHIP Services' bi-monthly managed care organization leadership meetings.
- Across Health and Human Services Commission
 - Coordination between OIG, Medicaid CHIP Services and the Financial Services Division.

Cost Avoidance and Waste Prevention Activities



Rider 151, Article II, Health and Human Services Commission

OIG reviewed cost avoidance and waste prevention activities employed by managed care organizations and as a result made the following recommendations:

- Require reporting of performance measures based on the dollar value of costs avoided and the value of costs avoided as a percent of total paid claims.
- Require managed care organizations to use standard methodologies to calculate and evaluate their cost avoidance related to fraud, waste, and abuse prevention activities.
- Establish a workgroup with stakeholders to develop standardized methodologies for performance measure reporting managed care organizations to the state.

Special Investigative Units Review



Rider 152, Article II, Health and Human Services Commission

The OIG reviewed the managed care organizations' fraud, waste, and abuse activities and their special investigative units. As a result, the OIG made the following recommendations:

- Managed care organizations should employ an SIU manager whose time is 100 percent dedicated to direct oversight of their SIU and fraud, waste, and abuse activities.
- Meet contract requirements that will be developed by the state for the method and frequency of member verification of services.
- Employ or subcontract SIU staffing that includes, at minimum, a full-time equivalent position who is either an accredited investigator or an investigator who's a certified fraud examiner.
- Use standardized methodologies developed by the state, with stakeholders input, to calculate and evaluate their cost avoidance savings related to fraud, waste, and abuse prevention activities.
- Require SIU staff, including those employed by a third party to conduct SIU activities, to attend national organizations' fraud, waste, and abuse focused trainings to learn and adopt innovative techniques for the prevention, detections, and investigation of fraud, waste, and abuse.
- Ensure program integrity activities are integrated into each business area responsible for providing support to the SIU and/or executing fraud, waste, and abuse activities through documented and up to date policies and procedures that clearly define roles, responsibilities and performance expectations.
- Periodically review and revise algorithms for fraud, waste, and abuse detection focused data analytics.
- Use non-traditional third-party resources to gather information to aid in fraud, waste, and abuse detection and investigation efforts.



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Questions?



An Audit Report on

**The Health and Human Services
Commission's Management of Its
Medicaid Managed Care Contract with
Superior HealthPlan, Inc. and Superior
HealthPlan Network, and Superior's
Compliance with Reporting
Requirements**

January 2018

Report No. 18-015



An Audit Report on

*The Health and Human Services **Commission's** Management of Its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements*

SAO Report No. 18-015
January 2018

Overall Conclusion

Superior HealthPlan, Inc. and Superior HealthPlan Network (Superior) accurately reported the approximately \$1.9 billion in medical (fee-for-service) claims and prescription drug claims it paid for the Medicaid STAR+PLUS managed care program in its financial statistical reports for fiscal year 2016. It should improve its compliance with reporting requirements to ensure that it reports only allowable costs.

However, the Health and Human Services Commission (Commission) did not ensure that its business practices aligned with its managed care contract requirements. For example, the Commission allowed Superior to report bonus and incentive payments paid to affiliate employees in its financial statistical report, which are unallowable costs under its contract with Superior. The disparities between the **Commission's** actual business practices and the written contract requirements weakens **the Commission's ability** to consistently oversee all of the contracts the Commission has with its other Medicaid Managed Care Organizations (MCOs).

The Commission did not ensure that its business practices aligned with its managed care contract.

The Commission did not ensure that its business practices related to its uniform managed care contract with Superior aligned with the written requirements in the contract and its *Uniform Managed Care Manual*. Specifically, **in Superior's financial** statistical report for fiscal year 2016, the Commission:

- Allowed Superior to report approximately \$29.6 million in bonus and incentive payments paid to affiliates' employees that were unallowable under the contract with Superior.

Background Information

Superior HealthPlan, Inc. and Superior HealthPlan Network (Superior) provides the Medicaid STAR, STAR+PLUS, STAR Health, and STAR Kids programs to seven service delivery areas in Texas: Bexar, Dallas, Lubbock, Nueces, Medicaid Rural Service Area (MRSA) - Central, MRSA - West, and Hidalgo (see Appendix 3 for additional information on those service delivery areas).

From September 1, 2015, through August 31, 2016, Superior received payments from the Health and Human Services Commission (Commission) that totaled \$2.4 billion for the STAR+PLUS program. Approximately \$2.2 billion of that funding paid for medical claims and prescription drug claims for 1,735,028 people enrolled in the STAR+PLUS program.

Sources: The Commission.

- **Approved Superior's request to report affiliate profits as costs without** following the approval process outlined in its contract with Superior.

By not following the written requirements in its contract with Superior, the Commission weakens its ability to consistently oversee the contract and creates a lack of transparency in its administration of Medicaid managed care programs.

The Commission also included in its contract with Superior a limitation on reporting the cost of executive compensation that may not be enforceable.

Superior reported medical and prescription claims accurately. However, it should improve its compliance with reporting requirements.

Superior's controls over its financial reporting process provided reasonable assurance that it accurately reported to the Commission the approximately \$1.9 billion in medical claims and prescription drug claims that Superior paid in fiscal year 2016 for the Medicaid STAR+PLUS managed care program (STAR+PLUS).

While Superior reported medical and prescription claims accurately, it did not comply with certain reporting requirements outlined in the **Commission's** Uniform Managed Care Contract and *Uniform Managed Care Manual*, resulting in unallowable and questioned costs in its financial statistical report for fiscal year 2016. Superior included approximately \$31.2 million in unallowable costs (including the approximately \$29.6 million in bonus and incentive payments that the Commission allowed Superior to report). Superior also included \$443,909 in questioned costs. Including unallowable and questioned costs in the financial statistical report affects **the calculation of Superior's net** profit, which the Commission uses to determine whether Superior owes money to the State under the experience rebate profit-sharing requirement. Table 1 on the next page shows the unallowable and questioned costs that Superior reported on its financial statistical report for fiscal year 2016.

Financial Statistical Reports

The Commission receives financial statistical reports from managed care organizations (MCOs) on a quarterly and annual basis as required by the **Commission's contracts with** the MCOs. Those reports are the primary statements of financial results the MCOs submit to the Commission. The Commission **uses the reports to analyze the MCOs'** membership, revenues, expenses, and net income by service area and program. The reports provide a basis for calculating the amount a MCO may owe the State through the experience rebate profit-sharing requirement (see Appendix 6 for information on the experience rebate).

Source: The Commission.

Table 1

Unallowable and Questioned Costs, Per the <i>Uniform Managed Care Manual</i> , That Superior Reported on Its Financial Statistical Report (FSR) for Fiscal Year 2016				
Type of Expense/ FSR Line Item	Reported Costs for Fiscal Year 2016	Total Unallowable Costs Identified	Total Questioned Costs Identified	Report Subchapter Discussing the Costs
Costs That Were Unallowable and Questioned per the <i>Uniform Managed Care Manual</i> , But That the Commission Allowed Superior to Include in Reported Costs				
Corporate Allocations ^a	\$ 119,132,444	\$ 28,846,721	\$ 0	Chapter 1-A
Bonuses	727,733	727,733	0	Chapter 1-A
Subtotals	\$ 119,860,177	\$ 29,574,454	\$ 0	
Costs That Were Unallowable and Questioned Per the <i>Uniform Managed Care Manual</i>				
STAR+PLUS Medical Fee-for-Service ^b	\$ 1,578,551,710	\$ 1,311,841	\$ 0	Chapter 2-A
Salaries	98,343,968	2,309	0	Chapter 2-B
STAR+PLUS Total Other Medical Expenses ^b	58,897,764	44	1,975	Chapters 2-B
Other Administrative Expenses	13,388,215	127,149	35,872	Chapter 2-B
Legal and Professional Services	8,184,061	98,751	139,658	Chapter 2-B
Travel Expenses	2,636,561	71	0	Chapter 2-B
Rent, Lease, or Mortgage Payment for Office Space	4,712,133	0	266,404	Chapter 2-B
Corporate Allocations ^c	(see above)	102,799	0	Chapter 2-B
Subtotals	\$1,764,714,412	\$ 1,642,964	\$443,909	
Totals	\$1,884,574,589	\$ 31,217,418	\$443,909	
^a Of the \$119,132,444 reported in the Corporate Allocations line item, \$28,846,721 was bonus and incentive payments to affiliates' employees. ^b These line items show expenses reported for only the Medicaid STAR+PLUS program. All other line items show expenses reported as administrative costs that Superior had for the STAR, STAR+PLUS, CHIP, STAR Health, STAR Kids, and the Dental Program. ^c The \$102,799 of unallowable costs was due to overreporting administrative expenditures.				

Source: Superior's financial statistical report for fiscal year 2016.

In addition, Superior should improve processes related to processing medical and prescription claims. Specifically, Superior did not consistently respond to appeals **and notify providers about appeals as required by the Commission's *Uniform Managed Care Manual***.

Auditors communicated other, less significant issues to the Commission and Superior separately in writing.

Table 2 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 2

Summary of Subchapters and Related Issue Ratings		
Chapter/ Subchapter	Title	Issue Rating ^a
1-A	The Commission Allowed Superior to Report Bonus and Incentive Payments to Affiliate Employees in Fiscal Year 2016	Priority
1-B	The Commission Did Not Enforce Its Cost Principles Related to Reporting Affiliate Profits	Priority
1-C	The Commission Cited a Federal Regulation That Was Not Applicable to Its Medicaid Contracts Related to a Limitation for Reporting MCO Executive Compensation, and That Limitation May Not Be Enforceable	Priority
2-A	Superior Accurately Reported Medical and Prescription Claims in Its Financial Statistical Report for Fiscal Year 2016	Low
2-B	Superior Did Not Consistently Report Accurate Expenditures In Its Fiscal Year 2016 Financial Statistical Report	Medium
3-A	Superior Paid Claims for Drugs Covered by the Commission's Vendor Drug Program and Adjudicated Medical and Pharmacy Claims Within the Required Time Frames	Low
3-B	Superior Denied Medical Claims in Accordance with Its Contract; However, It Should Ensure That it Consistently Responds to Appeals and Notifies Providers About Appeals as Required	Medium
^a A subchapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity. A subchapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity. A subchapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level. A subchapter is rated Low if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.		

Summary of Management's Response

At the end of each chapter in this report, auditors made recommendations to address the issues identified during this audit. The Commission agreed with the findings and recommendations in Chapter 1 that address its oversight of the Superior contract. The **Commission's detailed management responses** are presented immediately following the recommendations in Chapter 1.

Superior provided management responses to the findings and recommendations in Chapter 1 that were addressed to the Commission. Superior disagreed with the

findings related to employee bonuses and incentive payments and affiliate profits. Superior provided a summary **of its management's response**. That summary and **Superior's responses to the issues discussed in Chapter 1** are presented in Appendix 8.

Superior agreed with the recommendations addressed to it in Chapter 2 and 3. **However, it disagreed with certain findings in those chapters related to Superior's reported expenditures and auditors' data analysis of paid medical and prescription claims. Superior's detailed management responses are presented immediately following the recommendations in Chapters 2 and 3.**

After review and consideration of Superior's management's responses, the State Auditor's Office stands by its conclusions based on evidence presented and compiled during this audit.

Audit Objective and Scope

The objective of this audit was to determine whether selected financial processes and related controls at a Medicaid managed care organization are designed and operating to help ensure (1) the accuracy and completeness of data that the Medicaid managed care organization reports to the Commission and (2) compliance with applicable requirements.

The scope of this audit covered Superior's contracts with the Commission to deliver the Texas Medicaid program. It covered Superior's financial statistical reports and its reported medical claims and pharmacy claims for fiscal year 2016. It also included the Commission's management of its contract with Superior, including the two most recent agreed-upon procedures engagements for which it contracted with an external audit firm.

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Detailed Results

Chapter 1

The Commission's Business Practices Did Not Align with Its Contract with Superior to Deliver the Texas Medicaid Program, and Its Limit on Reporting MCO Executive Compensation May Not Be Enforceable

Cost Principles

The Commission's cost principles are part of its *Uniform Managed Care Manual*, which contains policies and procedures that all Managed Care Organizations (MCOs) participating in Medicaid programs are required to follow. The *Uniform Managed Care Manual* is incorporated by reference into the contract between the Commission and MCOs.

Source: The Commission.

The Health and Human Services Commission's (Commission) business practices did not align with its contract with Superior HealthPlan, Inc. and Superior HealthPlan Network (Superior). Specifically, the Commission did not adhere to certain provisions within the cost principles, which is part of its contract with Superior, related to reporting affiliate employee bonus and incentive payments and affiliate profits as costs in Superior's financial statistical report for fiscal year 2016 (see text box for information about the contract and the cost principles).

In addition, the Commission's limitation on reporting the cost of executive compensation in financial statistical reports may not be enforceable because the Commission cited a federal regulation that is not applicable to its contracts with Medicaid managed care organizations (MCOs).

Chapter 1-A

The Commission Allowed Superior to Report Bonus and Incentive Payments to Affiliate Employees in Fiscal Year 2016

Chapter 1-A
Rating:
Priority ¹

The cost principles in the Commission's contract with Superior state that "bonuses paid or payable to affiliates are unallowable." However, the Commission allowed Superior to report bonus and incentive payments paid to its affiliates' employees as costs to deliver Texas Medicaid programs (see Appendix 4 for contract language related to bonus and incentive payments).

In its financial statistical report for fiscal year 2016, Superior reported \$29,574,454 of bonus and incentive payments² paid to employees of affiliate companies. It reported \$28,846,721 (98 percent) of those bonus and incentive payments within the single corporate allocation line item (that line

¹ The risk related to the issues discussed in Chapter 1-A is rated as Priority because the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

² The reported bonus and incentive payments included cash bonuses and incentive plan payments, such as stock options.

item totaled \$119,132,444³). Reporting bonus and incentive payments paid to employees of affiliate companies within the corporate allocation line item decreases transparency over the expenditure of Medicaid managed care funds. For example, auditors identified the bonus and incentive payments to affiliate employees while reviewing the supporting documentation for the expenses reported in the corporate allocation line item. Superior reported the remaining \$727,733 of bonus and incentive payments in the financial statistical report's bonus line item.

Reporting affiliate bonus and incentive payments as costs in the financial statistical report is a business practice known to the Commission. Superior does not have employees; all staff working for Superior are employees of affiliate companies (Centene Company of Texas, LP or Centene Management, LLC). (See Appendix 5 for an organizational chart with bonus and incentive payments for Superior's affiliates.)

Experience Rebates

Texas Government Code, Section 533.014, requires the Commission to adopt rules that ensure MCOs share profits they earn through the Medicaid managed care program. The Commission has incorporated profit-sharing provisions into its contracts with MCOs that require MCOs to share certain percentages of their net income before taxes with the Commission (see Appendix 6 for more information on how experience rebates are calculated).

The General Appropriations Act (84th Legislature), Rider 13, page II-88, requires that experience rebates the Commission receives from MCOs be spent on funding services for Medicaid.

Allowing Superior to report bonus and incentive payments, which are unallowable costs under the Commission's cost principles, results in Superior understating its net profit in its financial statistical report. That affects the calculation that determines whether Superior owes money to the Commission under the experience rebate profit-sharing requirements (see text box and Appendix 6 for more information on experience rebates).

By not requiring MCOs to follow the written requirements in its contract related to reporting bonus and incentive payments to affiliates, the Commission weakens its ability to oversee its contracts consistently and creates a lack of transparency in its administration of Texas Medicaid managed care programs.

Recommendations

The Commission should:

- Adhere to its cost principle that states bonus and incentive payments are unallowable costs for financial statistical reports, or amend the cost principles to allow bonus and incentive payments to reflect current business practices.

³ The corporate allocation line item consisted of compensation expenses (\$42,331,022), non-compensation expenses (\$47,954,701), incentive plan expenses such as stock options (\$16,621,142), and annual bonus expenses (\$12,225,579) that Superior made to its parent company or affiliates.

- If it amends its cost principle to allow MCOs to report bonus and incentive payments to affiliates, require MCOs to report bonus and incentive payments paid to affiliates separately from the corporate allocation line item in financial statistical reports to increase transparency.

The Commission's Management's Response

The Health and Human Services Commission (HHSC) is in agreement with the findings and associated recommendations and offer the following responses.

HHSC will amend the contracts with the MCOs to clarify the definition of affiliates to be consistent with business practices which have evolved over the last several years. FSR reporting will also be amended to show affiliate bonuses as a separate line item.

Implementation Date:

HHSC will issue a contract amendment effective September 1, 2018 which will clarify the definition of affiliates and the treatment of affiliate bonuses.

Responsible Person:

Director of Financial Reporting and Audit Coordination

Chapter 1-B

The Commission Did Not Enforce Its Cost Principles Related to Reporting Affiliate Profits

Chapter 1-B
Rating:
Priority ⁴

The Commission did not require Superior to follow the approval process outlined in its cost principles for reporting affiliate profits even though it was aware that Superior included affiliate profits in its financial statistical reports. Specifically, for a MCO to report an affiliate's profit as a cost, it must obtain the Commission's prior written approval, which is called a "comparable unaffiliated sales exception." To obtain the exception, the cost principles require a MCO to submit documentation prior to receiving an exception that demonstrates that the prices charged to the MCO are comparable to the prices that the affiliate charges to unrelated third parties. However, the Commission approved an exception for Superior without obtaining or reviewing documentation on affiliate pricing.

⁴ The risk related to the issues discussed in Chapter 1-B is rated as Priority because the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

In addition, although the Commission's cost principles require MCOs to report and separately identify affiliate profits, the Commission did not include a section in the template for the financial statistical report for MCOs to separately identify and report affiliate profits.

By not enforcing the written requirements related to reporting affiliate profits, the Commission weakens its ability to effectively oversee its managed care contracts. In addition, not including a section in the financial statistical report template for MCOs to separately identify and report affiliate profits creates a lack of transparency in the Commission's administration of the Texas Medicaid programs.

Recommendations

The Commission should:

- Obtain and review MCO documentation on affiliate pricing before providing written approval for a comparable unaffiliated sales exception.
- Include a section in its template for financial statistical reports to separately identify and report affiliate profits.

The Commission's Management's Response

The Health and Human Services Commission (HHSC) is in agreement with the findings and associated recommendations and offer the following responses.

The Medicaid and CHIP Services Department within HHSC currently collaborates with Actuarial Analysis and contract auditors in analyzing affiliate pricing arrangements. That process uses data that is collected from MCOs through various channels. HHSC will clarify the MCOs' responsibilities in conforming to the requirements of that process in an amendment to the MCO contracts.

HHSC will evaluate reporting methodologies that would give the appropriate level of transparency to affiliate transactions without exposing MCO proprietary data.

Implementation Date:

HHSC will issue a contract amendment effective September 1, 2018. The amendment will define the process that MCOs will follow to justify pricing in affiliate arrangements.

Affiliate data reporting will commence with 1st quarter FY 2019.

Responsible Person:

Director of Financial Reporting and Audit Coordination

Chapter 1-C

The Commission Cited a Federal Regulation That Was Not Applicable to Its Medicaid Contracts Related to a Limitation for Reporting MCO Executive Compensation, and That Limitation May Not Be Enforceable

Chapter 1-C
Rating:
Priority ⁵

The Commission's *Uniform Managed Care Manual* incorporates a federal acquisition regulation that includes a limitation on executive compensation. However, that federal acquisition regulation (Title 48, Code of Federal Regulations, Part 31) related to the executive compensation limitation is applicable only to cost-based contracts. In its cost principles, which are part of its contract with Superior, the Commission explicitly defined its contract with Superior as a fixed-price contract. As a result, the Commission's limitation for reporting the cost of executive compensation may not be enforceable.

The Commission contracts with external audit firms to perform limited reviews related to the executive compensation limitation as part of agreed-upon procedures (AUP) engagements. However, those AUPs, for which the Commission approves the procedures, may not be sufficient to identify all instances in which the contractor exceeds the limitation on executive compensation. For example, an AUP report for fiscal year 2014 evaluated whether Superior's bonus and incentive payments for the top five highest compensated individuals exceeded the Commission's limitation on executive compensation. That report concluded that Superior had exceeded the limitation on executive compensation by \$6.9 million for those five individuals. However, pursuant to the approved procedures, testing was not expanded to determine whether the reported compensation costs for other employees exceeded the limitation. In its management response to the AUP report, Superior disagreed that the executive compensation limitation was applicable to its contract with the Commission.

⁵ The risk related to the issues discussed in Chapter 1-C is rated as Priority because the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

Recommendation

The Commission should:

- Review and adjust, if necessary, its cost principle regarding the executive compensation limitation to ensure that it is enforceable.
- Ensure that AUPs include sufficient procedures to identify all employees whose compensation exceeds the limitation on executive compensation.

The Commission's Management's Response

The Health and Human Services Commission (HHSC) is in agreement with the findings and associated recommendations and offer the following responses.

HHSC will develop language related to allowable executive compensation which specifically defines a cap.

HHSC will ensure that Agreed-Upon-Procedures include a procedure which identifies instances where MCO compensation exceeds the contract limit.

HHSC will also review and modify, if necessary, specific contract language that invokes the Federal Acquisition Regulations (FAR). The objective is to ensure that the FAR does not diminish HHSC's ability to establish firm contract requirements.

Implementation Date:

HHSC will issue a contract amendment effective September 1, 2018.

AUPs for the next cycle will have sufficient procedures to identify MCO employees who exceed the compensation cap.

Responsible Person:

Director of Financial Reporting and Audit Coordination

Superior Reported Medical and Prescription Claims Accurately in Its Financial Statistical Report for Fiscal Year 2016; However, It Did Not Comply With Certain Reporting Requirements

Superior's financial reporting process provided reasonable assurance that it accurately reported certain costs in its financial statistical report for fiscal year 2016. Specifically, Superior accurately reported STAR+PLUS medical (fee-for-service) and prescription expenses totaling approximately \$1.9 billion. However, Superior did not report some of its expenses accurately in its 2016 financial statistical report. The issues discussed in Chapter 2 address the accuracy of Superior's financial statistical report for fiscal year 2016.

Chapter 2-A

Superior Accurately Reported Medical and Prescription Claims in Its Financial Statistical Report for Fiscal Year 2016

Chapter 2-A
Rating:
Low ⁶

Auditors reconciled the reported \$1.6 billion in paid medical expenses to Superior's claims processing system and matched the amount to within less than 1 percent. Auditors also reconciled the \$362.7 million in paid prescription expenses to Superior's pharmacy claims data and matched the amount to within less than 1 percent.

In addition, auditors compared medical and prescription claims for the STAR+PLUS program that Superior paid in fiscal year 2016 to eligibility data from the Commission and determined that Superior paid medical and prescription claims to eligible members.

The Commission's *Uniform Managed Care Manual* requires a MCO to process and pay Medicaid provider claims in accordance with the benefits limits and exclusions as listed in the *Texas Medicaid Provider Procedures Manual*. Auditors reviewed 11.4 million paid medical claims that Superior paid during fiscal year 2016 (reported at \$1.6 billion) and determined that Superior paid claims for medical procedures covered by Texas Medicaid as part of its STAR+PLUS program. However, auditors identified 1,635 paid claims for procedure codes that were not covered by Texas Medicaid. The total cost of those uncovered claims was \$1.3 million in Superior's financial statistical report for fiscal year 2016, which was less than 1 percent of Superior's total paid medical claims for that time period.

⁶ Chapter 2-A is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/function(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Recommendations

Superior should improve its processes to ensure that it:

- Pays only for covered medical claims.
- Reports only covered medical claims in its financial statistical reports.

Superior's Management's Response

The errors identified were a very low percentage of the 11.4 million claims processed by Superior during fiscal year 2016. Superior will review and improve its processes.

Superior Did Not Consistently Report Accurate Expenditures in Its Fiscal Year 2016 Financial Statistical Report

Chapter 2-B
Rating:
Medium ⁷

Auditors tested random samples of expenditures⁸ that Superior reported in its fiscal year 2016 financial statistical report. That expenditure testing identified \$331,123 in unallowable costs and \$433,909 in questioned costs (see text box for information about those types of costs). The inaccuracies identified may affect the calculation of Superior's net income, which the Commission uses to determine whether Superior owes money to the Commission under the experience rebate profit-sharing requirement. (See Table 3 on the next page for detailed results of the expenditure testing.)

Costs were identified as unallowable because:

- Superior reported \$226,015 in expenditures in its fiscal year 2016 financial statistical report that it did not incur during that time period. **The Commission's *Uniform Managed Care Manual* states that a MCO should report expenditures in its financial statistical report based on the dates it incurred a service. Superior's policies and procedures did not address the requirement that it report only expenditures incurred within the reporting period of its financial statistical report.**

- Superior overreported \$2,309 in salary expenditures. **Auditors identified eight expenditures for employees that Superior either incorrectly included in or excluded from its financial statistical report for fiscal year 2016. Superior's review process did not identify the inaccuracies.**
- Superior overstated administrative expenditures by \$102,799. **Superior reported expenditures related to outsourced services in both the outsourced**

Unallowable Cost

The **Commission's *Uniform Managed Care Manual*** defines the cost principles that establish allowability of expenses related to selected Medicaid programs that a MCO can report on its financial statistical report (FSR). A designation of "allowable" or "unallowable" does not generally govern whether the MCO can incur a cost or make a payment; allowability reflects only what is reportable on the FSR. To be allowable, expenses must conform to the **requirements of the Commission's cost principles**, which include being reasonable and allocable.

Questioned Cost

According to the Code of Federal Regulations, a "questioned cost," is a cost charged that MCO management, federal oversight entities, an independent auditor, or other audit organization authorized to conduct an audit of a MCO has questioned because of an audit or other finding. A cost may be questioned because:

- There may have been a violation of a provision of a law, regulation, contract, grant, or other agreement or document governing the use of MCO funds.
- The cost is not supported by adequate documentation.
- The cost incurred appears unnecessary or unreasonable and does not reflect the actions that a prudent person would take in the circumstances.

Sources: **The Commission's *Uniform Managed Care Manual***, and Title 45, Code of Federal Regulations, Section 1630.2(g).

⁷ The risk related to the issues discussed in Chapter 2-B is rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

⁸ Except for third-party recovery expenditures, which auditors selected a risk-based sample of expenditures due to the quantity of line items for each payment related to that expense.

services and corporate allocation line items. Superior's review process did not identify the overstatement.

Table 3 shows the detailed results for the unallowable costs that auditors identified through expenditure testing of Superior's financial statistical report for fiscal year 2016.

Table 3

Testing Results for Unallowable Costs					
Line Item	Number of Expenditures Tested	Number of Unallowable Expenditures	Percent of Tested Expenditures in Error	Dollar Amount Tested	Dollar Amount of Unallowable Costs
Other Medical Expenses ^a	50	2	4%	\$ 36,812	\$ 44
Legal and Professional Services	30	8	27%	488,251	98,751
Other Administrative Expenses	49	17	35%	281,471	127,149
Travel	50	5	10%	3,588	71
Salaries	75	8	11%	110,084	2,309
Totals	254	40	16%	\$920,206	\$228,324 ^b
^a Line item reported for the STAR+PLUS program only. ^b The total amount does not include the \$102,799 in overstated administrative expenditures described in the previous page.					

Source: Auditor testing of expenditures reported in Superior's financial statistical report for fiscal year 2016.

In addition to the unallowable costs discussed above, auditors identified questioned costs. Specifically:

- Superior did not consistently ensure that it had sufficient supporting documentation for \$443,909 of reported expenses. **The Commission's uniform managed care contract requires a MCO to maintain records for administrative services or functions and provide to auditors detailed records and supporting documentation for all costs it reported. Superior's policies and procedures did not specify the documentation that it was required to maintain to support expenditures included in its financial statistical report.**

Table 4 on the next page shows the detailed results for the questioned costs that auditors identified during the testing of expenditures that Superior reported in its financial statistical report for fiscal year 2016.

Table 4

Testing Results for Questioned Costs					
Line Item	Number of Expenditures Tested	Number of Questioned Expenditures	Percent of Tested Expenditures in Error	Dollar Amount Tested	Dollar Amount of Questioned Costs
Other Medical Expenses ^a	50	1	2%	\$ 36,812	\$ 1,975
Legal and Professional Services	30	5	17%	488,251	139,658
Other Administrative Expenses	52	5	10%	430,955	35,872
Rent, Lease, or Mortgage	30	30	100%	266,404	266,404
Totals	162	41	25%	\$1,222,422	\$443,909
^a Line item reported for the STAR+PLUS program only.					

Source: Auditor testing of expenditures reported in Superior's financial statistical report for fiscal year 2016.

Recommendations

Superior should:

- Update its policies and procedures to ensure that it reports only items incurred within the reporting period for financial statistical reports.
- Improve its reporting and review process for calculating and reporting expenditures in its financial statistical reports so that it (1) can identify any overstatements and (2) ensure that staff salaries are correctly reported.
- Update its policies and procedures to ensure that it retains adequate detailed documentation to support all expenses included in its financial statistical reports.

Superior's Management's Response

The majority of the \$443,909 of questioned costs relates to the auditor's questioning of Superior's rent expenses. It is disappointing that the technical accounting procedure for three (3) months of rent expenses that were offered as "rent-free" months has been labeled as a medium risk to the Texas Medicaid program. The disagreement here is nothing more than whether Superior should be allowed to use GAAP (Generally Accepted Accounting Principles) in considering the cost of the entire life of the lease and then finding a monthly expense by dividing the entire cost by the number of leased months. The first bullet in Chapter 2-B does not provide this context. Considering the context, the auditor appears to assert that, for those months

in which no rent payment was required, Superior should not be allowed to state a rent expense per understood GAAP requirements that reflect an overall monthly cost of the entirety of the lease.

Superior incurs, records and reports rent expenses on a straight line basis, as prescribed by GAAP. As the auditor has referenced within this report, MCOs are instructed to report expenditures in the period incurred rather than on a cash basis. Superior has provided its lease contracts and ledger activity that agree with and support the amounts reported as expenses (Note: Superior's lessors do not provide invoices for monthly payments). Superior considers this adequate documentation.

Additionally, the auditor's statement regarding "adequate...documentation," does not mean documentation did not exist for the financial statistical reports. Superior will review its systems to ensure the level of detail the auditors require will be available. This has no financial impact on the cost of the program.

Auditor Follow-up Comment

The *Uniform Managed Care Manual*, which is incorporated into Superior's contract with the Commission, states that the financial statistical report should include only paid expenses that support the Texas Medicaid program. Superior provided documentation regarding the Rent, Lease, or Mortgage line item. However, the documentation provided did not support the actual amounts paid, resulting in questioned costs.

Superior Should Improve Certain Processes Related to Processing Medical and Prescription Claims

Overall, Superior paid only for drugs covered by the Commission's vendor drug program and adjudicated and paid or denied the medical and pharmacy claims it received within the time frames required by its contract with the Commission. However, Superior did not consistently respond to appeals and notify providers as required by its contract. The issues discussed in Chapter 3 address Superior's processes and compliance with requirements related to delivering the Medicaid STAR+PLUS program.

Chapter 3-A

Superior Paid Claims for Drugs Covered by the Commission's Vendor Drug Program and Adjudicated Medical and Pharmacy Claims Within the Required Time Frames

Chapter 3-A
Rating:
Low⁹

Superior paid prescription claims for the STAR+PLUS program for drugs covered by the Commission's Vendor Drug Program's drug formulary. Of the approximately 3.3 million prescription claims for \$362.7 million paid during fiscal year 2016 that auditors reviewed, more than 99 percent were for drugs covered by the drug formulary.¹⁰

In addition, Superior ensured that medical claims for the STAR+PLUS program were adjudicated within the required time frames. The Commission's *Uniform Managed Care Manual* requires that once a MCO receives a "clean claim" (see text box for explanation of a clean claim), it is required within the 30-day claim payment period to: (1) pay the total amount of the claim, or part of the claim, in accordance with the contract or (2) deny the entire claim, or part of the claim, and notify the provider why the claim will not be paid.

The Commission's *Uniform Managed Care Manual* also states that a MCO is subject to remedies, including liquidated damages, if it does not pay providers interest

Clean Claims

Title 28, Texas Administrative Code, Section 21.802(6), defines a clean claim as follows:

- For nonelectronic claims, a claim submitted by a physician or a provider for medical care or health care services rendered to an enrollee under a health care plan or to an insured person under a health insurance policy that includes required data elements and the amount paid by a health plan.
- For electronic claims, a claim submitted by a physician or a provider for medical care or health care services rendered to an enrollee under a health care plan or to an insured person under a health insurance policy using the ASC X12N 837 format and in compliance with all applicable federal laws related to electronic health care claims, including applicable implementation guides, companion guides, and trading partner agreements.

⁹ Chapter 3-A is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

¹⁰ Superior did not include the paid claims for drugs not covered by the drug formulary in its financial statistical report for fiscal year 2016 or as part of the encounter data reported to the Commission.

for the full period in which the clean claim or a portion of the clean claim remains unadjudicated beyond the 30-day claims processing time period.

Of the approximately 11.4 million paid medical claims (reported at \$1.6 billion) that auditors reviewed, approximately 11.3 million (99 percent) were adjudicated within the required time frames. Auditors identified 132,140 claims that were adjudicated from 1 day to 623 days after the required time frame. Superior did not pay the required interest for 10,285 (8 percent) of those late claims.

In addition, Superior ensured that it adjudicated all 3.5 million paid prescription claims that auditors reviewed within 18 days as required during fiscal year 2016.

Recommendations

Superior should improve its processes to ensure that it:

- Adjudicates all claims within required time frames.
- Pays interest on the claims that were not adjudicated within the required time frames.

Superior's Management's Response

Auditors selected "non-statistical, random samples" which should be considered in reviewing the results regarding the percent of error. However, Superior will review its adjudicated claims processes and implement any necessary improvements. Superior will pay interest when required.

Auditor Follow-up Comment

Auditors did not conduct sampling of paid medical claims. Data analysis was conducted on the entire population to test the timeliness of the adjudication of the approximately 11.4 million paid medical claims, and whether the required interest was paid for claims that were not processed within required timeframes.

Superior Denied Medical Claims in Accordance with Its Contract;
However, It Should Ensure That it Consistently Responds to
Appeals and Notifies Providers About Appeals as Required

Chapter 3-B
Rating:
Medium ¹¹

Of the approximately 11.4 million paid medical claims that auditors reviewed, 958,347 were denied claims. Auditors reviewed a random sample of 25 of those denied medical claims and determined that Superior included an explanation for the denial and adjudicated the denial within 30 days, as required by the Commission's *Uniform Managed Care Manual*.

Auditors received a separate file of 1,243 appealed claims for fiscal year 2016. Auditors reviewed a random sample of 25 of those appealed medical claims and determined that:

- For 1 (4 percent) claim, Superior did not respond to the appeal within 30 days as required.
- For 2 (8 percent) claims, Superior did not retain any evidence that it notified the provider regarding the disposition of the appeal as required.

Recommendations

Superior should improve its processes to ensure that it:

- Responds to all appealed medical claims within required time frames.
- Communicates the disposition of all appealed medical claims to its providers as required.

Superior's Management's Response

The auditors selected "non-statistical, random samples" which invalidates the accuracy of these results regarding the percent of error. Also, and by way of example, in many cases, errors in filing the claims prevented Superior from responding within the 30 days. Nevertheless, Superior will give the results consideration and review its appeals and notification process, implement any necessary improvements, and communicate the disposition of all appeals to its providers.

¹¹ The risk related to the issues discussed in Chapter 3-C is rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

Auditor Follow-Up Comment

The samples were designed to be representative of the population. The error rates may be projected to the population. However, the accuracy of the projection cannot be measured. Please see Appendix 1 for more information about auditors' sampling methodology.

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether selected financial processes and related controls at a Medicaid managed care organization (MCO) are designed and operating to help ensure (1) the accuracy and completeness of data that the Medicaid managed care organization reports to the Health and Human Services Commission (Commission) and (2) compliance with applicable requirements.

Scope

The scope of this audit covered Superior HealthPlan, Inc. and Superior HealthPlan Network's (Superior) contracts with the Commission to deliver the Texas Medicaid program. It covered Superior's financial statistical reports and its reported medical claims and pharmacy claims for fiscal year 2016. It also included the Commission's management of its contract with Superior, including the two most recent agreed-upon procedures (AUP) engagements for which it contracted with an external audit firm.

Methodology

The audit methodology included selecting a MCO based on risk by obtaining and reviewing information from the Commission. Additionally, the audit methodology included collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating results of the tests, and interviewing management and staff at Superior and the Commission.

Data Reliability and Completeness

Auditors assessed the reliability of data used in the audit and determined the following:

- For medical claims data managed by Superior's claims processing system and pharmacy claims data from Superior's subcontractor's pharmacy benefits system, auditors reconciled claims data to claim payment totals reported on Superior's financial statistical reports and to medical claims and pharmacy claims reported to the Commission. In addition, auditors reconciled payroll data to Superior's general ledger. Auditors determined that the medical claims data and pharmacy claims data, payroll data, and

Superior's general ledger was sufficiently reliable for the purposes of this audit.

- Auditors relied on Superior's external auditors' prior work on general and application controls for Superior's (1) claims processing system, (2) financial accounting system, and (3) third-party vendor systems and determined that data from those three information systems was sufficiently reliable for the purposes of this audit.

Sampling Methodology

For the samples discussed below, auditors applied a nonstatistical sampling methodology primarily through random selection. Auditors selected the following samples:

- To test for allowability, appropriateness, and adequate support, auditors selected nonstatistical, random samples through random selection designed to be representative of the population. Specifically, auditors selected :
 - ♦ Twenty-five service coordinator salary, wages, and overtime expenditures from Superior's payroll system.
 - ♦ Twenty-five service coordinator travel expenditures from Superior's accounting system.
 - ♦ Twenty-five related party transactions from Superior's accounting system.
 - ♦ Thirty rent, lease, and mortgage payments related to the rent, lease, and mortgage line item from Superior's accounting system.
 - ♦ Thirty legal and professional services expenditures from Superior's accounting system.
 - ♦ Fifty travel expenses from Superior's accounting system.
 - ♦ Twenty-five expenditures related to the other administrative expenses line item from Superior's accounting system.
 - ♦ Twenty-five denied claims and 25 appealed claims from Superior's claims system.

Test results for the samples listed above may be projected to the population, but the accuracy of the projection cannot be measured.

To test for proper classification, appropriateness, and adequate support, auditors selected nonstatistical, random samples designed to be

representative of the population from Superior's payroll system of salary, wages, and overtime expenditures for 75 employees. Test results may be projected to the population, but the accuracy of the projection cannot be measured.

To test for allowability, appropriateness, and adequate support, auditors selected a nonstatistical, risk-based sample of 27 third-party recovery transactions from Superior's accounting system. The sample items were not generally representative of the population; therefore, it would not be appropriate to project the test results to the population.

Information collected and reviewed included the following:

- The Commission's STAR+PLUS contracts with Superior.
- The Commission's STAR+PLUS member eligibility records for Superior.
- Superior's medical claims and pharmacy claims data.
- Superior's policies and procedures.
- Superior's 90-day and 210-day financial statistical report for fiscal year 2016.
- Superior's payroll and human resources records for fiscal year 2016.
- Superior's supporting documentation for calculating reported allocated corporate costs for fiscal year 2016.
- External audit reports and consultant reports on Superior's claims processing system, financial accounting system, and select third-party vendor systems.
- The Commission's required MCO reports, manuals, and AUP reports.
- Superior's subcontractor agreements with its pharmacy benefit manager and affiliate companies.

Procedures and tests conducted included the following:

- Reviewed required reports, bonus and incentive payment plans, and encounter data that Superior submitted to the Commission.
- Reviewed the fiscal years 2013 and 2014 AUPs prepared by the Commission's external auditors to determine whether the AUP identified or addressed significant weaknesses or areas of concern related to selected line items in Superior's financial statistical reports for fiscal years 2013 and 2014.

- Recalculated and reconciled selected medical expenses and administrative expenses line items in Superior's financial statistical report for fiscal year 2016 to the Superior's general ledger.
- Tested to determine whether service coordinator salaries, wages, overtime, and travel expenditures reported in the other medical line item of Superior's financial statistical report for fiscal year 2016 were allowable, appropriate, and adequately supported.
- Tested to determine whether Superior's reported payroll expenditures were appropriately classified and allocated, incurred in fiscal year 2016, and adequately supported.
- Tested to determine whether transactions reported in the related party expenses line item of Superior's fiscal year 2016 financial statistical report were allowable, appropriate, and adequately supported.
- Tested to determine whether payments reported in the rent, lease, and mortgage line item of Superior's fiscal year 2016 financial statistical report were allowable, appropriate, and adequately supported.
- Tested to determine whether expenditures reported in the legal and professional services line item of Superior's fiscal year 2016 financial statistical report were allowable, appropriate, and adequately supported.
- Tested to determine whether expenditures reported in the travel expenses line item of Superior's fiscal year 2016 financial statistical report were allowable, appropriate, and adequately supported.
- Tested to determine whether administrative expenditures and third-party recovery transactions reported in the other administrative expenses line item of Superior's fiscal year 2016 financial statistical report were allowable, appropriate, and adequately supported.
- Tested to determine whether denied and appealed claims were adjudicated according to the Commission's contract requirements and whether interest was paid if needed.
- Reviewed Superior's corporate allocation methodology to determine reasonableness and allowability.
- Analyzed and tested all STAR+PLUS medical and pharmacy claims for fiscal year 2016 to determine whether they were paid in accordance with the Commission's contract requirements, and submitted for STAR+PLUS eligible members.

Criteria used included the following:

- The General Appropriations Act (84th Legislature).
- Title 48, Code of Federal Regulations, Part 31.
- Title 41, United States Code, Sections 1127 and 4304.
- Texas Government Code, Chapters 531, 533, and 536.
- Title 1, Texas Administrative Code, Chapters 353 and 370.
- The Commission's uniform managed care contract for STAR+PLUS with Superior.
- The Commission's *Uniform Managed Care Manual*.
- The Commission's *Uniform Managed Care Pharmacy Claims Manual*.
- The Commission's Vendor Drug Program drug formulary.
- The Commission's *Texas Medicaid Provider Procedures Manual*.
- The Commission's *Texas Medicaid Pharmacy Provider Procedures Manual*.
- The Commission's Texas Medicaid fee schedule.

Project Information

Audit fieldwork was conducted from March 2017 through December 2017 year. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Arby James Gonzales, CPA, CFE (Project Manager)
- Serra Tamur, MPAff, CISA, CIA (Assistant Project Manager)
- Katherine Curtsinger
- Scott Labbe, CPA

- Anca Pinchas, CPA, CISA, CIDA
- Sarah Rajiah
- Adam K. Ryan
- Cameron Scanlon, CFE
- Felicia Villela
- Dennis Bushnell, CPA (Quality Control Reviewer)
- Brianna C. Pierce, CPA (Quality Control Reviewer)
- John Young, MPAff (Audit Manager)

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 5 provides a description of the issue ratings presented in this report.

Table 5

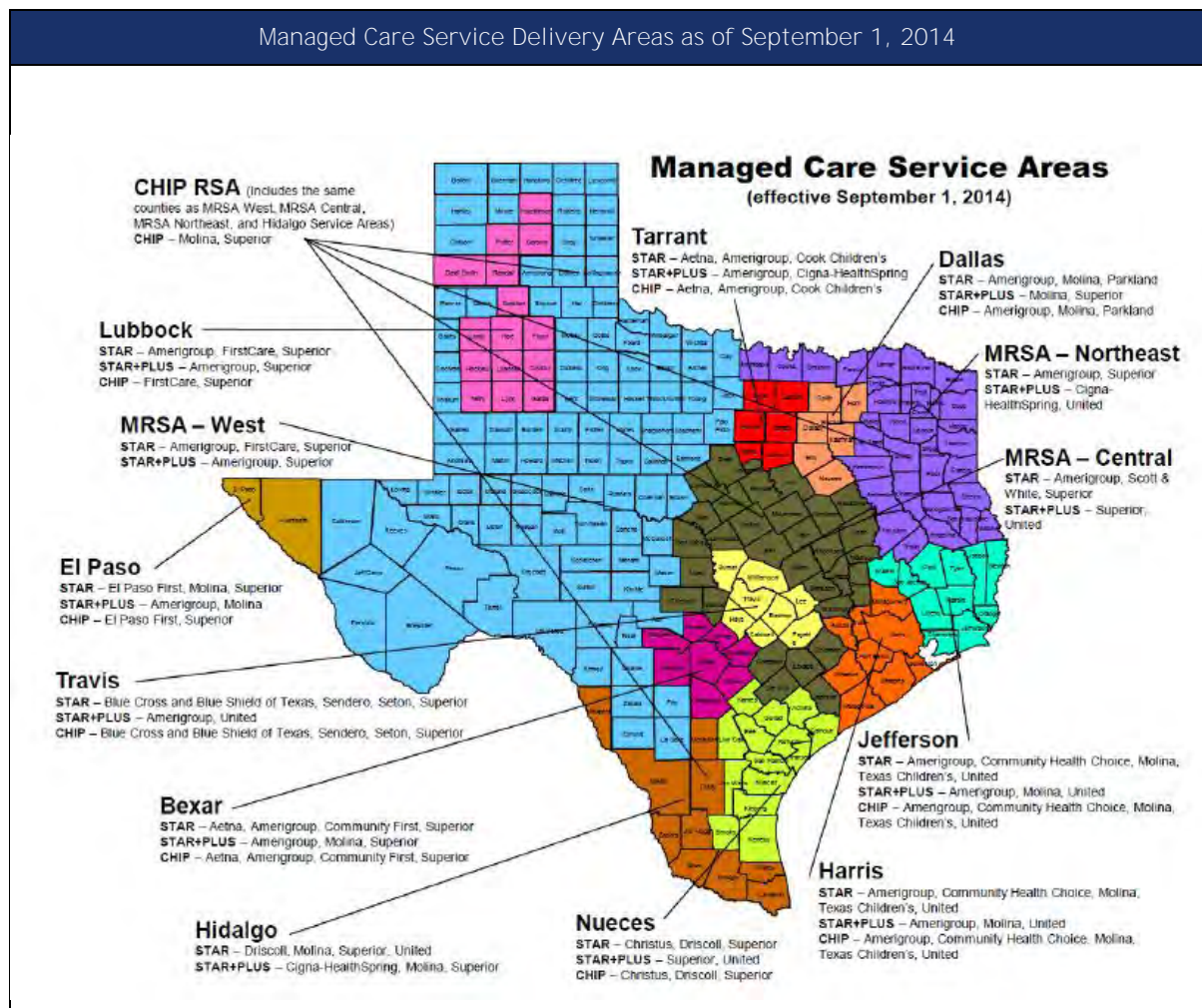
Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Superior's Service Delivery Areas for STAR+PLUS

Superior HealthPlan, Inc. and Superior HealthPlan Network (Superior) provides Medicaid STAR+PLUS services to seven service delivery areas in Texas through its contracts with the Health and Human Services Commission. Those seven service delivery areas are: Bexar, Dallas, Lubbock, Nueces, Medicaid Rural Service Area (MRSA) - Central, MRSA - West, and Hidalgo (for Superior HealthPlan Network).

Figure 1 is a regional map that shows the location of all the managed care service delivery areas, including Superior's service delivery areas as of September 1, 2014.

Figure 1



Source: The Commission.

Excerpts from Superior's Uniform Managed Care Contract and the Commission's Uniform Managed Care Manual Related to Bonus and Incentive Payment Plans

Below is an excerpt from Section 7.2.4.1 of uniform managed care contract between Superior HealthPlan, Inc. and Superior HealthPlan Network and the Health and Human Services Commission (Commission).

Employee Bonus and/or Incentive Payment Plan

If the MCO intends to include Employee Bonus or Incentive Payments as allowable administrative expenses, the MCO must furnish a written Employee Bonus and/or Incentive Payments Plan to HHSC. The written plan must include a description of the MCO's criteria for establishing bonus and/or incentive payments, the methodology to calculate bonus and/or incentive payments, and the timing of bonus and/or incentive payments. The Bonus and/or Incentive Payment Plan and description must be submitted during the Transition Phase, no later than 30 days after the Effective Date of the Contract. If the MCO substantively revises the Employee Bonus and/or Incentive Payment Plan during the Operations Phase, the MCO must submit the revised plan to HHSC at least 30 days in advance of its effective date.

HHSC reserves the right to disallow all or part of a plan that it deems inappropriate. Any such payments are subject to audit, **and must conform within the Uniform Managed Care Manual, Chapter 6.1, "Cost Principles for Expenses"** [emphasis added].

Below is an excerpt from the Commission's *Uniform Managed Care Manual*, Chapter 6.1, "Cost Principles for Expenses" Section VI(14)(i) related to bonus and incentive payment plans.

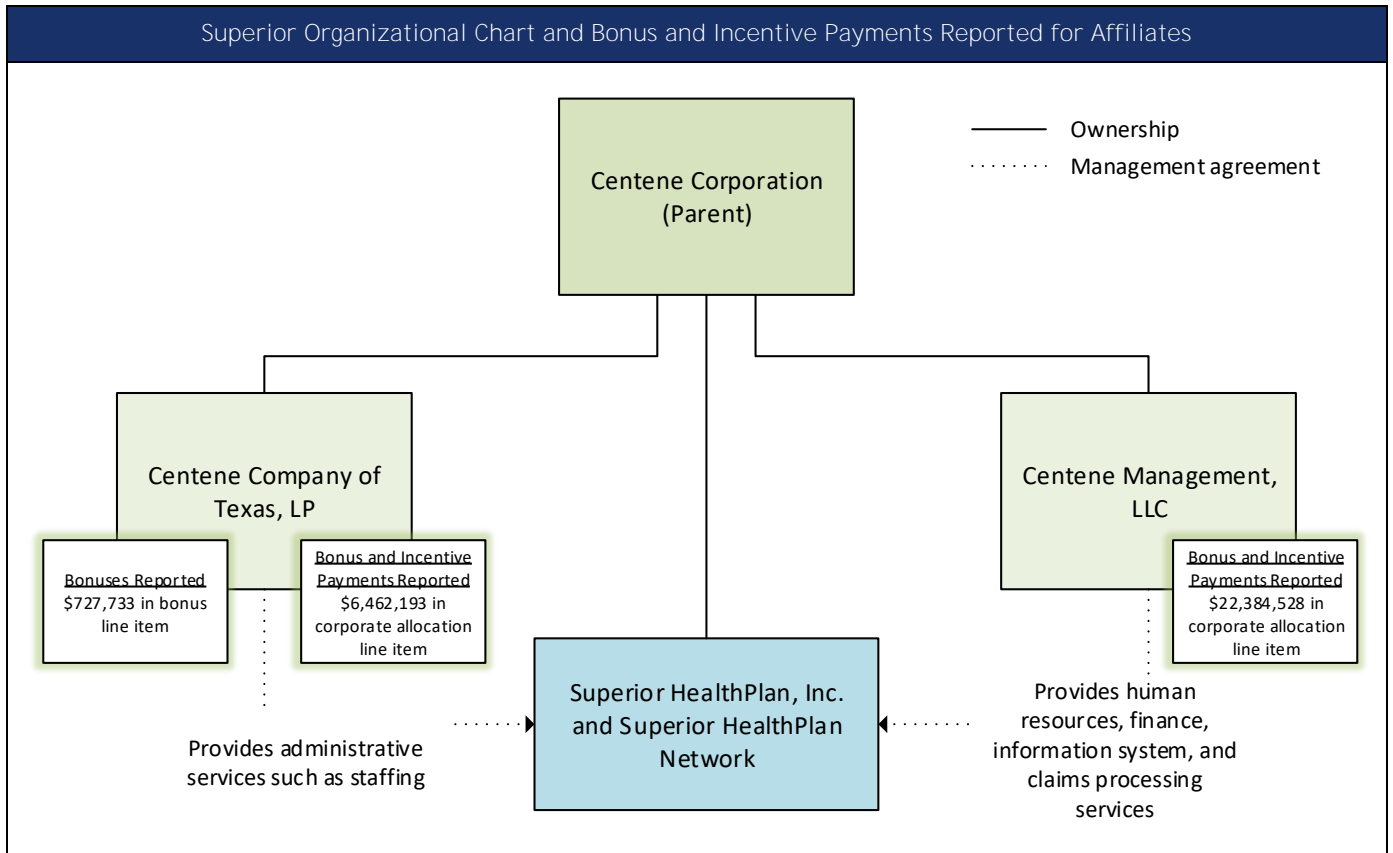
Employee Bonuses or Incentive Payments.

1. Employee bonuses are allowable if they are:
 - (a) Part of and in conformance with an existing plan that has been submitted at least nine months in advance to HHSC, and which is in compliance with any relevant specific terms of the Contract, such as those describing the criteria required for an employee bonus or incentive payment plan;
 - (b) Based on individual or group performance with respect to clearly-stated goals within a defined period (generally either the MCO's fiscal year, the MCO Parent's fiscal year, the calendar year, or the FSR reporting period); and
 - (c) Paid after the end of and within 90 days of the defined period, and is not contingent upon future services any recipient would provide.
2. **Bonuses paid or payable to an Affiliate are unallowable.** [emphasis added].

Superior's Organizational Chart with Bonus and Incentive Payments for Affiliates

Figure 2 shows an organizational chart for Superior HealthPlan, Inc. and Superior HealthPlan Network (Superior) with bonus and incentive payments for affiliates.

Figure 2



Source: Auditors created the figure based on information Superior reported to the Commission.

Calculating Experience Rebates

Texas Government Code, Section 533.014, requires the Health and Human Services Commission (Commission) to adopt rules that ensure that managed care organizations (MCOs) share profits they earn through the Medicaid managed care program. Title 1, Texas Administrative Code, Section 353.3, states that each MCO participating in Medicaid managed care must pay to the State an experience rebate calculated according to the graduated rebate method described in the MCO's contract with the Commission. The Commission has incorporated profit-sharing provisions into its contracts with MCOs that require MCOs to share certain percentages of their net income before taxes with the Commission. The General Appropriations Act (84th Legislature), Rider 13, page II-88, requires that experience rebates the Commission receives from MCOs be spent on funding services for Medicaid.

According to the Commission's contracts with MCOs, a MCO must pay an experience rebate to the Commission if the MCO's net income before taxes exceeds a certain percentage, as defined by the Commission, of the total revenue the MCO receives each fiscal period. The experience rebate is calculated in accordance with a tiered rebate method that the Commission defines (see Table 6). The tiers are based on the consolidated net income before taxes for all of the MCO's Medicaid program and Children's Health Insurance Program service areas that are included in the scope of the contract, as reported on the MCO's financial statistical reports (which the Commission reviews and confirms through annual agreed-upon procedures engagements performed by its contracted audit firms).

Table 6

Tiers for Experience Rebates		
Pre-tax Income as a Percent of Revenues	MCO Share	The Commission's Share
Less than or Equal to 3 percent	100 percent	0 percent
Greater than 3 percent and Less than or Equal to 5 percent	80 percent	20 percent
Greater than 5 percent and Less than or Equal to 7 percent	60 percent	40 percent
Greater than 7 percent and Less than or Equal to 9 percent	40 percent	60 percent
Greater than 9 percent and Less than or Equal to 12 percent	20 percent	80 percent
Greater than 12 percent	0 percent	100 percent

Source: The Commission's *Uniform Managed Care Terms and Conditions*.

Calculation of the Experience Rebate Superior Owed for Fiscal Year 2016

Based on Superior HealthPlan, Inc. and Superior HealthPlan Network's (Superior) unaudited financial statistical report for fiscal year 2016, the Health and Human Services Commission (Commission) calculated the experience rebate amount that Superior owed the Commission for that fiscal period. Table 7 shows the Commission's calculation of the income that is subject to the tiered rebate methodology described in Appendix 6.

Table 7

The Commission's Calculation of Superior's Income Subject to Experience Rebate for Fiscal Year 2016	
Unaudited Pre-tax Net Income	\$94,651,680
Admin Cap impact: Expenses reduced ^a	\$10,805,292
Cap-adjusted Pre-tax Net Income	\$105,456,972
Pre-implementation Costs	\$0
Adjusted Income Subject to Experience Rebate	\$105,456,972
^a The Admin Cap is a calculated maximum amount of administrative expenses that can be deducted from revenues for purposes of determining income subject to the experience rebate. While administrative expenses may be limited by the Admin Cap to determine experience rebates, all valid allowable expenses will continue to be reported on the financial statistical reports. The Admin Cap does not affect financial statistical reporting, but it may affect any associated experience rebate calculation. For fiscal year 2016, the \$10,805,292 amount is the difference between Superior's Admin Cap of \$337,743,981 and its reported administrative expenses of \$348,549,273.	

Source: The Commission.

Table 8 shows the Commission's calculation of the experience rebate that Superior owed the State for fiscal year 2016.

Table 8

The Commission's Calculation of Superior's Experience Rebate for Fiscal Year 2016					
Tiers - Percent of Revenue	Upper Rev Limit	Net Income	Superior's Share	State's Share	State's Share Percentage
0 percent to 3 percent	\$148,799,961	\$105,456,972	\$105,456,972	\$ 0	0 percent
3 percent to 5 percent	\$247,999,935	0	0	0	20 percent
5 percent to 7 percent	\$347,199,908	0	0	0	40 percent
7 percent to 9 percent	\$446,399,882	0	0	0	60 percent
9 percent to 12 percent	\$595,199,843	0	0	0	80 percent
Over 12 percent	No Limit	0	0	0	100 percent
Totals		\$105,456,972	\$105,456,972	\$0	

Source: The Commission.

Additional Management's Responses from Superior

In addition to its management's responses to the recommendations directed to it in Chapters 2 and 3 of this report, Superior HealthPlan, Inc. and Superior HealthPlan Network (Superior) submitted (1) a summary of its management's response and (2) detailed responses to the recommendations in Chapter 1 directed to the Health and Human Services Commission. That summary and those additional responses are presented below.

Summary

Superior disagrees with the auditors on two key issues, performance based incentive payments to employees and the reporting of affiliate cost. Superior disagrees with the auditor's interpretations of the cost principles and contract requirements. Further, Superior is concerned that the auditor chose to ignore: (1) the documentation of the long-standing course of performance by the parties; and (2) the manner in which both the Texas Health and Human Services Commission (HHSC) and Superior interpreted their own agreement in applying the Uniform Managed Care Manual's cost principles to the specific structure of Superior's participation in the Texas Medicaid program. Superior has consistently worked with HHSC to transparently disclose the employee incentive payments and the technicalities associated with a holding company staffing structure. HHSC has permitted the employee incentives (after receiving the required filings and request from Superior) consistent with allowances that would be available for a company not using Superior's structure. Superior believes this approach to be well within the letter, spirit, and intent of the cost principles. Similarly, Superior has made HHSC aware of its affiliate cost structure and both Superior and HHSC have arrived at an approach for the application of the cost principles to Superior's specific structure. The inconsistency between the auditor's findings and the well-established history of the course of performance between the parties to the agreement is further evidenced by more recent proposed changes to the referenced provisions by HHSC that would allow the parties to maintain the current approach.

Unfortunately, the auditor gave neither the history nor the proposed language changes any weight or context in the report and instead relied upon its own interpretation of a contractual and regulatory structure in which it does not have day-to-day experience. Incentive payments and affiliate cost could be considered by the auditor to be questionable costs,

rather than unallowable, due to the technical language issues raised by the auditor. However, the auditor should not ignore the documented decisions, planning, reporting and auditing of the costs for multiple years by the actual parties to the contract when communicating these issues in this report.

Chapter I-A

Superior does not agree with the auditor's interpretation of the cost principles regarding performance based compensation and incentive payments and is disappointed that the auditor chose to omit the fundamental contextual issues related to this issue, which include a technical inter-company staffing arrangement the auditor is not properly considering or explaining in presenting the interpretation, and a filing by Superior to HHSC seeking the approval of this compensation and incentive payment structure. The auditors have misinterpreted the cost principles relating to payments to employees in contrast to payment to an affiliate. The performance incentive payments identified are paid directly to employees providing contract services directly to Superior and not paid to an entity such as an affiliate for discretionary distribution to actual employees. Many of the employees in question are the only employees that can properly be attributed to Superior and they function as the day-to-day employees of Superior through a staffing agreement. The staffing agreement between Superior and Centene of Texas, Inc. (CTX), an affiliate of Superior, provides a level of simplicity for the holding company system in which Superior is a wholly owned subsidiary. CTX provides employees to Superior and does so for only Superior.

The cost principles are complex and the provision related to employee bonus and incentive payments unfortunately includes language regarding bonus payments to affiliates that does not make any reference to employees. This results in some ambiguity. Superior has long understood this language to prohibit bonus payments directly to affiliated entities for reaching certain performance targets and to not apply to employees who are technically employed through an affiliate but providing services specifically to Superior. HHSC's approval of Superior's filed employee bonus and incentive plans is consistent with that understanding and with the allowable employee bonus and incentive expenses for MCOs not utilizing this staffing structure. However, the auditor determined that this language should be interpreted to completely disallow the employee bonus and incentive payments. The ambiguity in the cost principle language should be resolved consistent with usual contract construction principles, which would properly consider the course of performance of

the parties to the agreement. This well understood contractual interpretation principle is expressed in numerous sources, including judicial decisions, the Restatement (Second) of Contracts, and in state statute at TEX. BUS. & COM. CODE sec. 1.303.

The HHSC cost principles allow MCOs to structure compensation arrangements to employees such that those employees are paid bonus or incentive payments. This is consistent with general practices in employment arrangements. The cost principles indicate that an MCO is not allowed to take the employee incentive payment allowance and use it to pay a bonus to an affiliate. To ensure that an MCO's planned employee incentive structure is consistent with the intent of the allowance, MCOs are required to file the details of the employee bonus and incentive structure with HHSC.

Incentive payments to Superior employees have been authorized by the Health and Human Services during the years that Superior has been a contractor. The payments are based on meeting established employee goals during the year. This issue is well known and understood by HHSC due to the filing process. Superior has been reviewed by HHSC's contracted third party auditors on multiple occasions through annual AUP reviews and the issue has not been raised as a finding in those reviews. The application of the cost principles in this audit report without a transparent effort to provide context, history, or reference to the pattern and practice of the parties subject to the cost principles agreement has provided an opportunity to issue a notable finding by the SAO, but the finding does not reflect the situation accurately.

Finally, Superior understands that the placement of the cost principle language regarding bonuses and incentives can be confusing in the context of an audit and can raise questions like those identified in the report. HHSC has recently proposed changes to the cost principles that Superior believes further clarify the intent of the language and eliminate opportunities for confusion in future reviews or audits.

Chapter I-B

Superior has worked cooperatively and transparently with HHSC for many years regarding the methodology for reporting the appropriate pricing of the services Superior receives from its affiliated entities. The annual Agreed Upon Procedures (AUP) reviews by a third party auditor contracted through HHSC also test this specific issue. Superior understands that the State Auditor's Office would raise the issue as being potentially inconsistent with a technical reading of the cost principles and

associated requirements. However, the issue is easily identified by an auditor's review because it is being handled by both HHSC and Superior in a transparent manner that includes Superior's requests to HHSC and HHSC's instructions regarding testing in the AUP reviews. The State Auditor's Office appears to have identified an opportunity to enforce the contract in a more stringent manner. Superior's position is that HHSC was aware of that opportunity and made a more fact-specific determination that is backed up by post-reporting third-party review. This context was also known to the State Auditor's Office but was not effectively communicated or referenced in the audit report.

Chapter 1-C

Superior's contract with HHSC is a risk-based contract. The Executive Compensation limitation (cited above) per federal requirements applies to cost reimbursement or solely cost-based contracts and thus does not affect this agreement. The recommendations in the report are not, in Superior's view, well-considered. The application of the Federal Acquisition Regulation (FAR) to the HHSC-MCO contracts is a much larger issue than the identified executive compensation matter. The complexity related to hundreds of pages of FAR regulatory requirements and decisions is not expertise routinely maintained by either the MCOs or HHSC. Recommending any changes to the method for referencing FAR is far more complicated than an effort at addressing a singular issue identified in this report.

Related State Auditor's Office Work

Related State Auditor's Office Work		
Number	Product Name	Release Date
18-006	A Report on Health and Human Services Contracts	December 2017
17-025	An Audit Report on HealthSpring Life and Health Insurance Company, Inc., a Medicaid STAR+PLUS Managed Care Organization	February 2017
17-007	An Audit Report on Medicaid Managed Care Contract Processes at the Health and Human Services Commission	October 2016

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair

The Honorable Joe Straus III, Speaker of the House, Joint Chair

The Honorable Jane Nelson, Senate Finance Committee

The Honorable Robert Nichols, Member, Texas Senate

The Honorable John Zerwas, House Appropriations Committee

The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Health and Human Services Commission

Mr. Charles Smith, Executive Commissioner

Superior HealthPlan, Inc. and Superior HealthPlan Network

Mr. Mark Sanders, Plan President and Chief Executive Officer



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The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

Audit Objective

- The objective of this audit was to determine whether selected financial processes and related controls at a Medicaid managed care organization are designed and operating to help ensure (1) the accuracy and completeness of data that the Medicaid managed care organization reports to the Health and Human Services Commission (Commission) and (2) compliance with applicable requirements.

Background

- The Commission contracts with Superior HealthPlan, Inc. and Superior HealthPlan Network (Superior) to provide the Medicaid STAR, STAR+PLUS, STAR Health, and STAR Kids programs to seven service delivery areas in Texas.
- From September 1, 2015, through August 31, 2016, Superior received payments from the Commission that totaled \$2.4 billion for the STAR+PLUS program.



The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

Background (continued)

- Approximately \$2.2 billion of that funding paid for medical claims and prescription drug claims for 1,735,028 people enrolled in the STAR+PLUS program.
- The Commission's *Uniform Managed Care Manual* contains policies and procedures that all MCOs participating in Medicaid programs are required to follow. The *Uniform Managed Care Manual* is incorporated by reference into the contract between the Commission and Managed Care Organizations (MCOs).
- Financial statistical reports are the primary statements of financial results that MCOs submit to the Commission. The Commission uses the reports to analyze the MCOs' membership, revenues, expenses, and net income by service area and program. The reports provide a basis for calculating the amount a MCO may owe the State through the experience rebate profit-sharing requirement.



The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

Overall Conclusion

Superior accurately reported the approximately \$1.9 billion in medical (fee-for-service) claims and prescription drug claims it paid for the Medicaid STAR+PLUS managed care program in its financial statistical reports for fiscal year 2016. It should improve its compliance with reporting requirements to ensure that it reports only allowable costs.

However, the Commission did not ensure that its business practices aligned with its managed care contract requirements. For example, the Commission allowed Superior to report bonus and incentive payments paid to affiliate employees in its financial statistical report, which are unallowable costs under its contract with Superior. The disparities between the Commission's actual business practices and the written contract requirements weakens the Commission's ability to consistently oversee all of the contracts the Commission has with its other MCOs.



The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

Overall Conclusion (continued)

Auditors rated the audit findings as noted below.

Summary of Subchapters and Related Issue Ratings		
Chapter/ Subchapter	Title	Issue Rating ^a
1-A	The Commission Allowed Superior to Report Bonus and Incentive Payments to Affiliate Employees in Fiscal Year 2016	Priority
1-B	The Commission Did Not Enforce Its Cost Principles Related to Reporting Affiliate Profits	Priority
1-C	The Commission Cited a Federal Regulation That Was Not Applicable to Its Medicaid Contracts Related to a Limitation for Reporting MCO Executive Compensation, and That Limitation May Not Be Enforceable	Priority
2-A	Superior Accurately Reported Medical and Prescription Claims in Its Financial Statistical Report for Fiscal Year 2016	Low
2-B	Superior Did Not Consistently Report Accurate Expenditures In Its Fiscal Year 2016 Financial Statistical Report	Medium
3-A	Superior Paid Claims for Drugs Covered by the Commission's Vendor Drug Program and Adjudicated Medical and Pharmacy Claims Within the Required Time Frames	Low
3-B	Superior Denied Medical Claims in Accordance with Its Contract; However, It Should Ensure That it Consistently Responds to Appeals and Notifies Providers About Appeals as Required	Medium
<p>^a A subchapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.</p> <p>A subchapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.</p> <p>A subchapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.</p> <p>A subchapter is rated Low if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.</p>		



The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

Findings Related to the Commission (Chapter 1-A)

- The Commission allowed Superior to report bonus and incentive payments to affiliate employees in fiscal year 2016, which is unallowable according to its contract. Reporting affiliate bonus and incentive payments as costs in the financial statistical report is a business practice known to the Commission.
- Superior reported \$29,574,454 of bonus and incentive payments paid to employees of affiliate companies in its financial statistical report for fiscal year 2016. Including unallowable costs affects the Commission's calculation that determines whether Superior owes money to the Commission under the experience rebate profit-sharing requirements.
 - \$28,846,721 of those bonus and incentive payments were reported within the single corporate allocation line item (that line item totaled \$119,132,444).
 - \$727,733 of bonus and incentive payments were reported in the financial statistical report's bonus line item.



The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

Findings Related to the Commission (Chapters 1-B and 1-C)

- The Commission did not require Superior to follow the approval process outlined in its cost principles for reporting affiliate profits. Specifically, for a MCO to report an affiliate's profit as a cost, it must obtain the Commission's prior written approval, which is called a "comparable unaffiliated sales exception." To obtain the exception, the cost principles require a MCO to submit documentation prior to receiving an exception that demonstrates that the prices charged to the MCO are comparable to the prices that the affiliate charges to unrelated third parties. In addition, the Commission did not include a section in the financial statistical report template to allow MCOs to separately identify and report affiliate profits.
- The Commission cited a federal regulation that was not applicable to its Medicaid contracts related to a limitation for reporting MCO Executive Compensation, and that limitation may not be enforceable. The regulation that the Commission cited is applicable only to cost-based contracts. In its cost principles, which are part of its contract with Superior, the Commission explicitly defined its contract with Superior as a fixed-price contract.



The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

Findings Related to Superior (Chapters 2-A, and 2-B)

- Superior accurately reported medical and prescription claims in its financial statistical report for fiscal year 2016. Superior reported \$1.6 billion in paid medical expenses and \$362.7 million in paid prescription expenses for the STAR+PLUS program. Auditors identified \$1.3 million in medical claims not covered by Texas Medicaid, which is less than 1 percent of Superior's total paid medical claims for the time period.
- Superior did not consistently report accurate expenditures in its financial statistical report for fiscal year 2016. Auditors identified \$331,123 in unallowable costs and \$433,909 in questioned costs.



The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

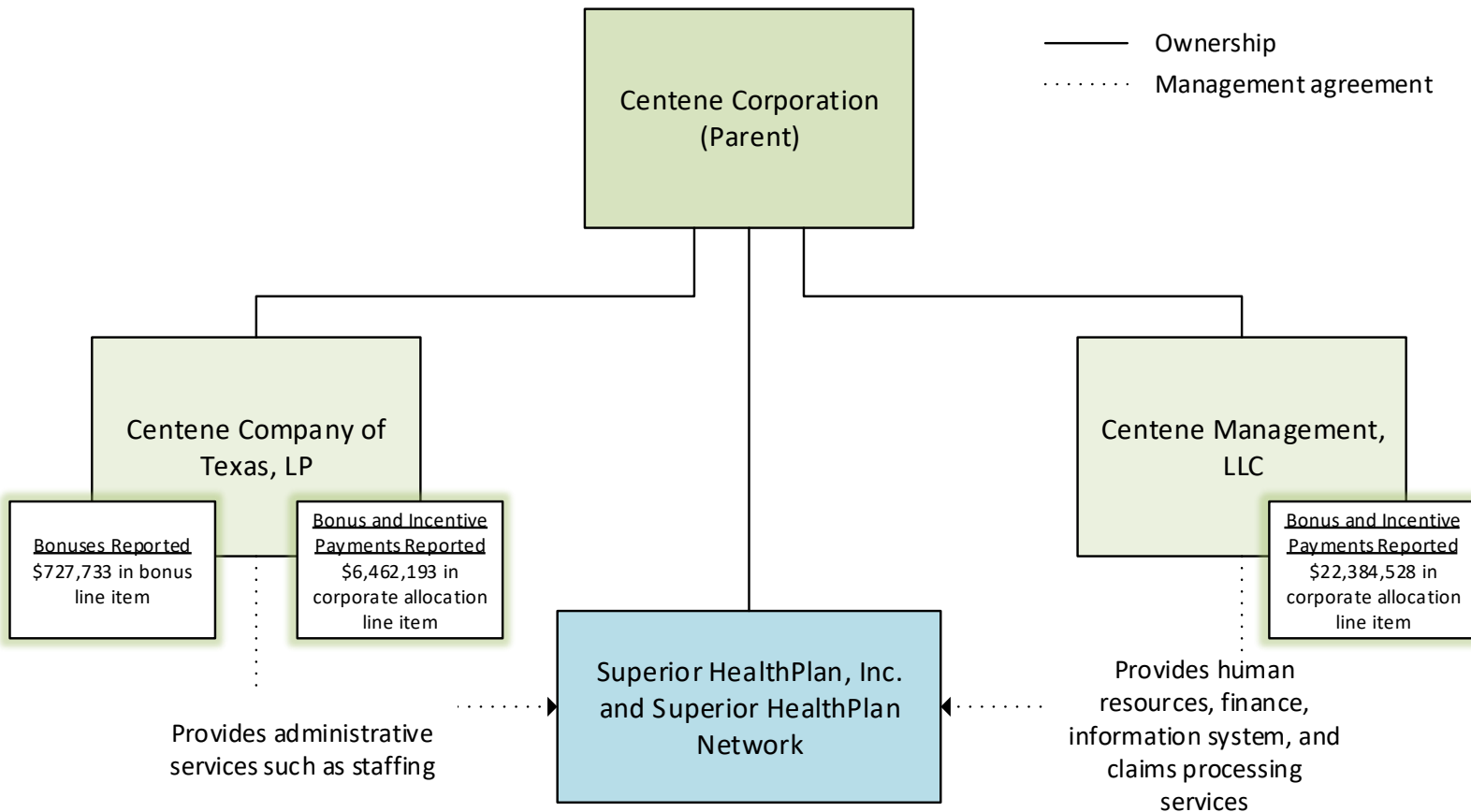
Findings Related to Superior (Chapters 3-A, and 3-B)

- Superior paid prescription claims for the STAR+PLUS program for drugs covered by the Commission's Vendor Drug Program. Superior also adjudicated medical and pharmacy claims within the required time frames.
- Superior denied medical claims in accordance with its contract; however, it should ensure that it consistently responds to appeals and notifies providers about appeals as required.



The Health and Human Services Commission's Management of its Medicaid Managed Care Contract with Superior HealthPlan, Inc. and Superior HealthPlan Network, and Superior's Compliance with Reporting Requirements

Superior Organizational Chart and Bonus and Incentive Payments Reported for Affiliates





LEGISLATIVE BUDGET BOARD

Border Security Update

**PRESENTED TO HOUSE APPROPRIATIONS SUBCOMMITTEE ON I, IV, AND V
LEGISLATIVE BUDGET BOARD STAFF**

APRIL 2018

Statement of Interim Charge

Continue to evaluate the effectiveness of state agencies' use of funds appropriated during the 85th Legislative Session for border security operations. Examine existing data and reporting on border security metrics. Monitor federal efforts to enhance security along the Texas-Mexico border to ensure that state resources are utilized optimally.

Article IX, Section 7.11, General Appropriations Act For the 2018-19 Biennium

- (a) The Department of Public Safety, Texas Military Department, Texas Parks and Wildlife Department, Trusteed Programs Within the Office of the Governor, Texas Department of Criminal Justice, Texas Alcoholic Beverage Commission, Texas Commission on Law Enforcement, Office of the Attorney General, Soil and Water Conservation Board, and any other agency as requested by the Legislative Budget Board, shall report all budgeted and expended amounts and performance indicators for border security as of February 28th and August 31st of each fiscal year to the Legislative Budget Board.
- (b) In this section, border security is defined as activities associated with deterring crimes and enforcing state laws related to offenses listed in the Texas Government Code, Section 772.0071, or hunting and fishing laws related to poaching, or for which Texas receives federal grants intended to enhance law enforcement, or that relate to federal law enforcement operations, between designated entry and exit points in counties:
 - (1) adjacent to or a portion of which is located within 20 miles of an international border; or
 - (2) adjacent to two counties located on an international border with a population of more than 5,000 and less than 7,500 according to the most recent decennial census; or
 - (3) adjacent to the Gulf Intracoastal Waterway, as defined by the Texas Transportation Code, Section 51.002(4).
- (c) This report shall be provided not later than 30 days after the reporting period specified in Subsection (a) and in a manner prescribed by the Legislative Budget Board. The report shall include, at a minimum:
 - (1) expended amounts and performance indicators for activities related to enforcing laws listed in Subsection (b) that occur:
 - (A) in each county in Subsection (b) as well as for activities statewide that support the definition included in Subsection (b); enforcement of those laws in these counties, and
 - (B) in any geographic region outside of the counties included in Subsection (b), as requested, such as areas identified as smuggling corridors;
 - (2) the method of finance of budgeted and expended amounts;
 - (3) the object of expense of budgeted and expended amounts; and
 - (4) regular and overtime pay.

Art IX, 7.11 Border Expenditure and Performance Data Collection

- Expenditure data collected beginning in FY2016
- Performance data collected beginning in FY2017
- First six months of FY2018 submitted in March 2018, and is currently being reviewed
- Expenditure and performance data is being prepared for online access on the LBB website as a Tableau interactive graphic
- Data will be graphically displayed and can be user-modified to view by fiscal year, agency, object of expense, performance category, etc.

Border Security All Funds Expenditures by Agency (in Millions)

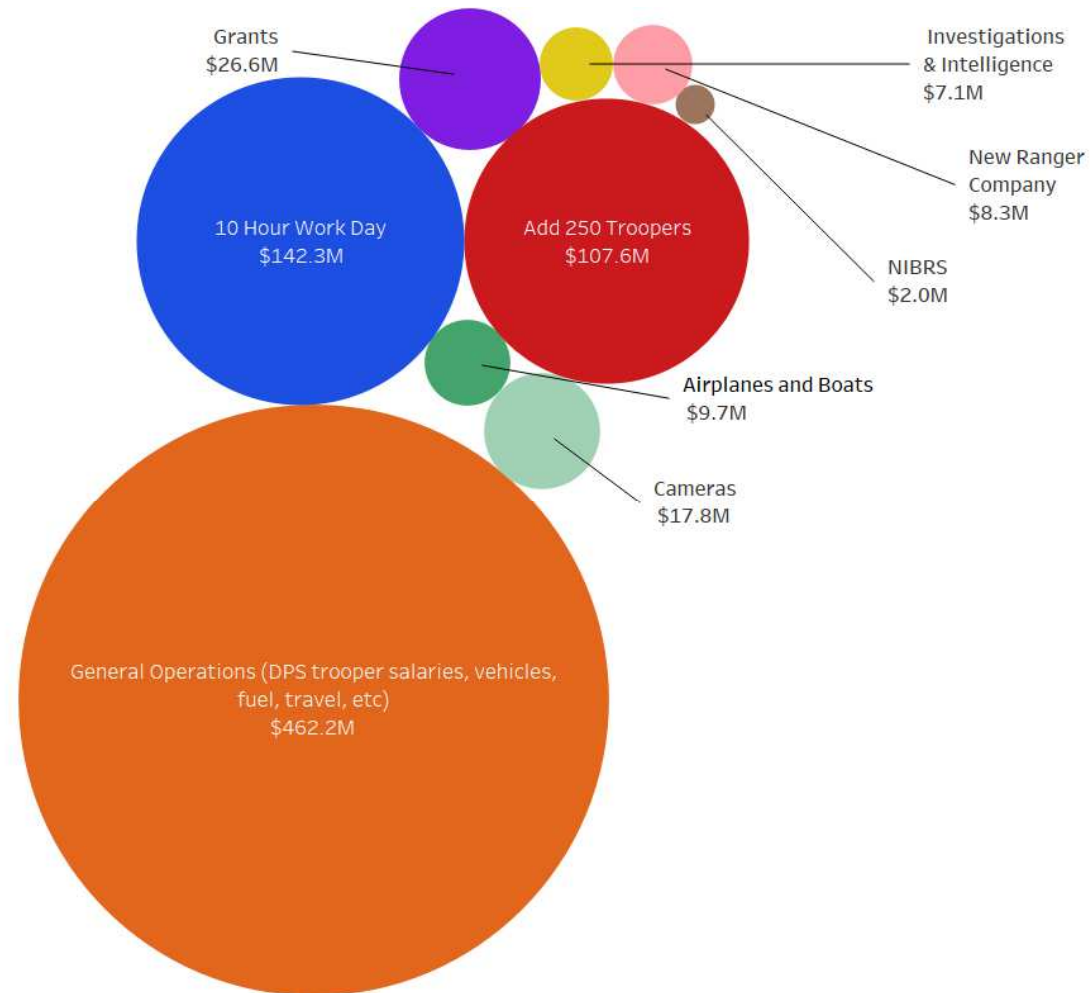
Agency	2016-17 Appropriations	2016-17 Expenditures in Border Counties	2016-17 Expenditures in Non- Border Counties	Total Expenditures
Department of Public Safety	\$749.9	\$378.7	\$299.7 ¹	\$678.5
Trusted Programs Within the Office of the Governor	\$38.4	\$20.1	\$26.1 ²	\$46.2
Texas Military Department	\$ -	\$36.1	\$ -	\$36.1
Texas Parks and Wildlife Department	\$10.0	\$15.3	\$1.6	\$16.9
Office of the Attorney General	\$ -	\$2.6	\$0.5	\$3.1
Texas Department of Criminal Justice	\$0.5	\$1.0	\$0.6	\$1.6
Texas Alcoholic Beverage Commission	\$1.2	\$1.1	\$ -	\$1.1
Texas Commission on Law Enforcement	\$0.2	\$0.1	\$0.1	\$0.2
Total	\$800.0	\$455.1	\$328.6	\$783.7 ³
Totals may not sum due to rounding				

¹ Includes base funding from prior biennia and increase for a statewide trooper 10-hour workday.

² Grants are provided in both border and non-border counties and include National Incident-Based Reporting System grants, Anti-gang grants, and grants to local law enforcement entities, among others.

³ Reported expenditures may include funding not identified as part of the \$800.0 million appropriation for border security.

Overview of Expenditures for 2016-17 Biennium



State Appropriations for Border Security, FY 2018-19

Agency	Funding Item Purpose	Appropriated FY 2018-19
DPS	Border security-related base	\$428.4
DPS	51-Hour Work Week	\$145.6
DPS	Additional 250 Troopers and Support Staff	\$97.1
DPS	Extraordinary Operations (Surge)	\$8.8
DPS	Equipment	\$7.0
DPS	Border Auto Theft Information Center	\$1.3
DPS	Penitas-Law Enforcement Center	\$3.2
DPS	NIBRS Training	\$0.7
Sub-total		\$694.3
TPWD	Baseline	\$11.4
TPWD	Game Wardens	\$10.6
TPWD	Extraordinary Operations (Surge)	\$7.0
TPWD	65-foot Vessel	\$4.0
Sub-total		\$33.0

Agency	Funding Item Purpose	Appropriated FY 2018-19
GOV	Prosecution resources (grants)	\$12.0
GOV	NIBRS Technology	\$11.3
GOV	Border Security Enforcement Activities	\$10.2
GOV	Anti-gang Activities	\$10.2
GOV	Sustain Year-round Flight Capability for Helicopters	\$6.0
GOV	Installation and Maintenance of Border Cameras	\$3.0
Sub-total		\$52.7
TABC	Baseline	\$5.7
TABC	Special Funding	\$1.2
Sub-total		\$6.9
TDCJ	Anti-gang program	\$1.6
TCOLE	Border	\$0.3
OAG	Border Prosecutions	\$2.6
TSWCB	Carrizo Cane Removal	\$3.0
DMV	Automobile Burglary and Theft Prevention Authority	\$5.6
TOTAL		\$800.0

National Guard Deployment

- In 2016-17, \$72.0 million in transitional funding was appropriated to support National Guard deployment as DPS was hiring and training 250 additional troopers for placement in the border regions.
- In 2018-19, DPS was appropriated \$8.8 million for a surge contingency; DPS has identified \$3.8 million for agency fuel and travel.
- The Governor has maintained National Guard deployment in FY 2018 which has been supported by the remaining \$5.0 million of surge contingency funding. DPS reports the \$5.0 million has been expended or encumbered at present.
- Through March 2018, 130 National Guardsmen were deployed to the Texas border.
- In April 2018, the President directed the US Secretary of Defense to request the deployment of National Guard personnel to the border. As of April 12, a total of 762 Texas National Guard troops were deployed.
- Deployment will increase by 300 each week until total deployment reaches 1,400.
- National Guard troops are assisting Customs and Border Patrol agents in surveillance and support roles.

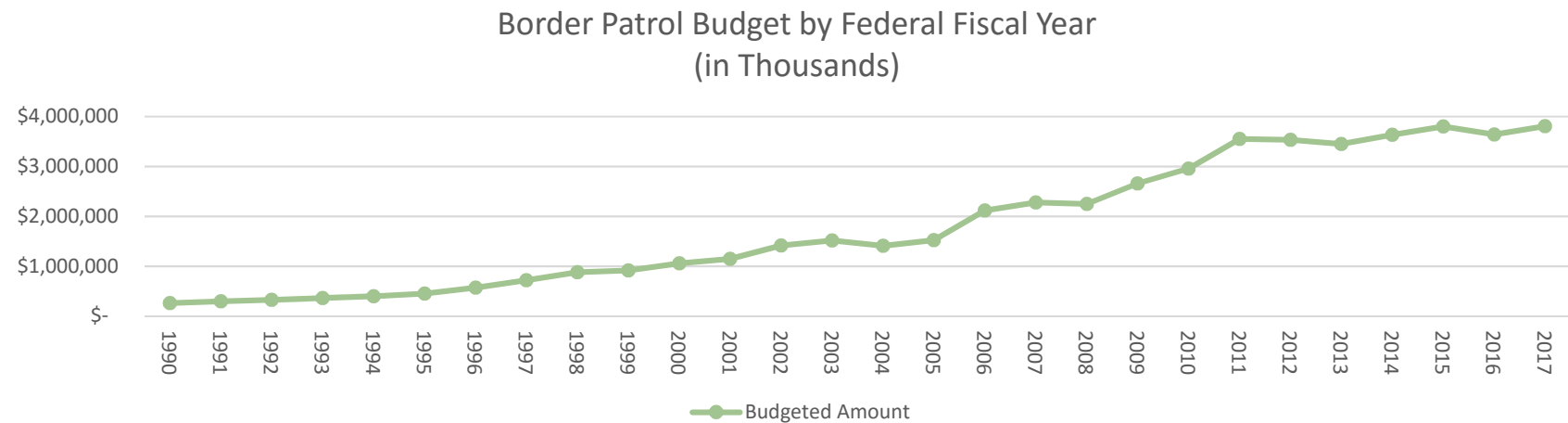
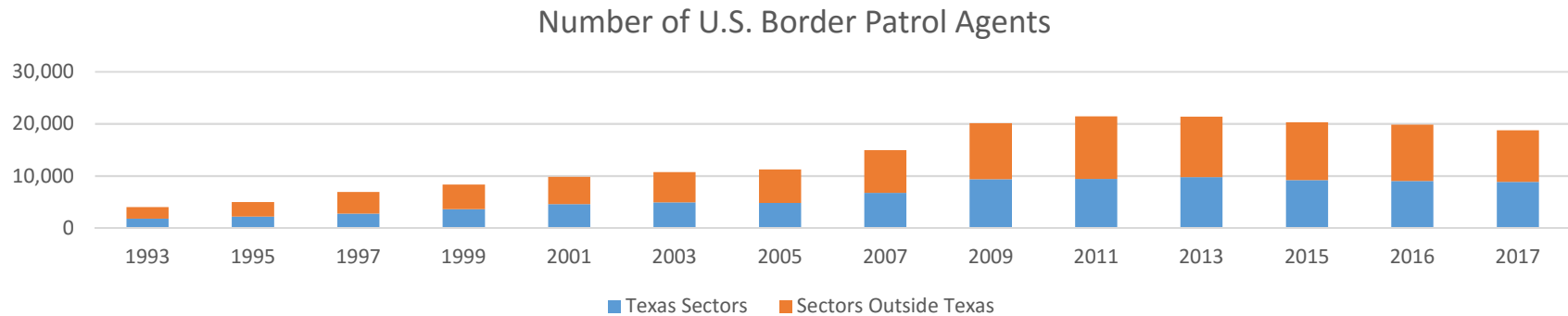
Border Security Performance Data Collection

- After discussions with agency staff, LBB established approximately 80 performance indicators across 8 affected agencies.
- First year of performance data is FY 2017.

Sample Indicators	Border Counties	Non-border Counties
# of smuggling apprehensions resulting from camera detection	42,816	
# of events detected in aircraft	1,569	2,744
# of smuggling apprehensions made with watercraft	947	
# of smuggling apprehensions made with land support	6,005	13,138
Pounds of drugs seized with land support	74,440	13,373
# of intelligence referrals received that are acted upon	44,696	43,952
# of intelligence referrals resulting in apprehensions	42,198	
# of border crime cases filed with Governor's grants	2,598	3,969
# of border crime cases advancing to trial with Governor's grants	2,368	3,722

Federal Resources Detail

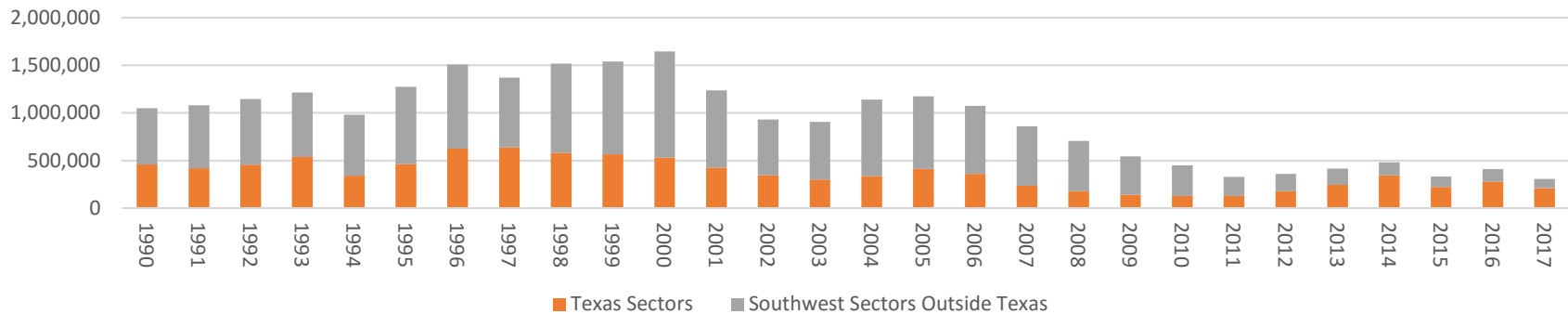
(Spending and Number of Border Patrol Agents)



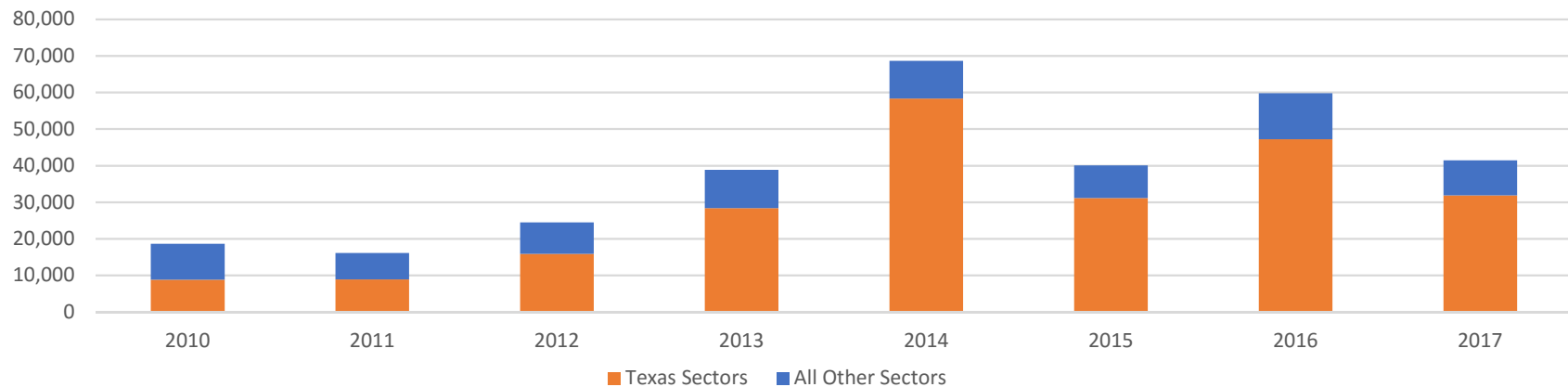
Data Source: U.S. Border Patrol

U.S. Border Patrol Apprehensions

Number of Illegal Alien Apprehensions By Federal Fiscal Year 1990-2017



Number of Unaccompanied Children Apprehensions by Federal Fiscal Year 2010-2017



Data Source: U.S. Border Patrol



LEGISLATIVE BUDGET BOARD

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Interim Charge #6 Place Holder

INFORMATION PAPER

SUBJECT: Operation Secure Texas (OST)

MISSION: Task Force Operation Secure Texas (TF-OST) conducts reconnaissance interdiction of transnational criminal organizations within U.S. Customs and Border Protection (USCBP) Zones 1-13 along the southern border of Texas in order to prevent human and drug trafficking operations.

The Texas Military Department (TMD) began deploying to the border in August of 2014 in a mission called Operation Strong Safety (OSS), now known as Operation Secure Texas (OST). This mission is conducted in support of the Department of Public Safety's effort to secure the Texas-Mexico border.

At the height of the mission in November 2014, Texas had successfully deployed 1000 troops. As of March 2018, approximately 115 troops were deployed in support of DPS along the border. TMD provides support to our partner agencies in several capacities to include aviation, surveillance, and reconnaissance.

OST TMD Events Summary Mission Totals from AUG 2014-APR 2018

Scouting	12,196
Illegal Alien Detections	22,447
Apprehensions (Law Enforcement Agency)	5,469
Turn Backs	8,605
Trans-Criminal Interdiction (Narcotics)	3,300

MISSION TOTALS since AUG 2014 52,017

COSTS: Since the start of the border mission in 2014, TMD has received approximately \$66.3M in funding through DPS and the Office of the Governor.

To sustain a level of operation with 115 troops deployed, costs are approximately \$1 million per month. This includes costs for pay and allowances of troops on State Active Duty Orders, lodging, transportation, fuel, and supplies.



Homeland Security Grants Division
Public Safety Office
Office of the Governor

Border Security Grants Data

Prepared for the House Appropriations Committee



Nancy Carrales
Executive Director
Homeland Security Grants Division, Office of the Governor
April 18, 2018

Grant Programs

What border security grant programs are administered by the Trusteed Programs within the OOG?

Purpose (State-Funded Grants)	Amount Appropriated 2018-19 Biennial Total (in Millions)
Prosecution Resources	\$12.0
Border Security Enforcement Activities	\$10.2
Sustain Year-round Flight Capacity for Helicopters	\$6.0
Installation and Maintenance of Border Cameras	\$3.0
National Incident-Based Reporting System (NIBRS) Technology	\$11.3
Anti-Gang Activities	\$10.2
Total	\$52.7*

Purpose (Federally-Funded Grants)	FY2018 Amount Appropriated by DHS (in Millions)
Operation Stonegarden (OPSG)	\$19.7

***Note:** In addition to this total, \$1.0 million was appropriated to the OOG “to provide financial assistance to first responder agencies in the Texas-Mexico border region for costs incurred while providing emergency response services associated with the execution of law enforcement activities related to border security...”



Prosecution Resources

BP – Border Prosecution Unit (BPU)

Purpose: To provide prosecution resources for District and County Attorneys along the Texas-Mexico border and for counties that are significantly affected by border crime.

“Border crime” is generally defined as any crime involving transnational criminal activity that undermines public safety or security, including homicide, kidnapping or person smuggling, trafficking of persons, sexual offenses, assaultive offenses, gambling, unlawfully carrying weapons, organized crime, arson, criminal mischief, other property damage, bribery and corruption, and drug crimes.

Program Activities:

- Prosecuting criminals charged with border crimes as defined by Texas Government Code §772.0071(a)(1)
- Training members of the unit and law enforcement agencies in the border region on specific issues and techniques relating to the investigation and prosecution of border crime

Financial Data:

- | | |
|---|--|
| <ul style="list-style-type: none">○ FY2017 (9/1/16 – 8/31/17)<ul style="list-style-type: none">▪ 19 grants▪ \$3.9M expended | <ul style="list-style-type: none">○ FY2018 (9/1/17 – 8/31/18)<ul style="list-style-type: none">▪ 20 grants▪ \$5.7M awarded |
|---|--|

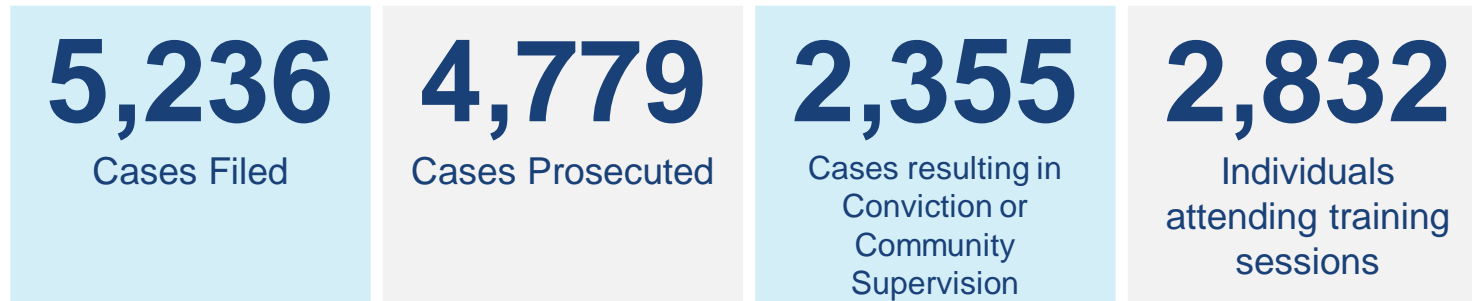


Prosecution Resources

BP – Border Prosecution Unit (BPU)

Effectiveness Indicators (Measures):

FY2017 (9/1/16 – 8/31/17)



FY2018 (9/1/17 – 2/28/18)

MEASURE	Actual as of 2/28/18
# of border crime cases filed	2,304
# of border crime cases advancing to trial	2,328
# of border crime cases referred for federal prosecution	68
# of border crime cases resulting in convictions or community supervision	1,161
# of individuals attending training sessions	2,330
# of training sessions conducted	95



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Office of the Governor

Border Security Enforcement Activities

BL – Local Border Security Program (LBSP)

Purpose: Operation Border Star centers on the use of intelligence to increase the effectiveness of federal, state, and local law enforcement assets.

Program Activities:

- The funds are used to sustain interagency law enforcement operations and enhanced patrols to deter and interdict criminal activity.
 - Overtime for peace officers
 - Limited overtime for law enforcement support and administrative personnel
 - Certain operational costs (e.g. fuel, vehicle maintenance and emergency repairs, etc.)
- The grant funds may also be used for the humane processing of the remains of undocumented migrants.

Financial Data:

○ FY2017 (9/1/16 – 8/31/17)

- 82 grants
- \$5.0M expended

○ FY2018 (9/1/17 – 8/31/18)

- 90 grants
- \$5.2M awarded



Border Security Enforcement Activities

BL – Local Border Security Program (LBSP)

Effectiveness Indicators (Measures):

FY2017 (9/1/16 – 8/31/17)

15,337

Intelligence Referrals

1,712

Felony arrests made
by grant paid officers

127,910

Hours of overtime of
grant paid officers

120

Unidentified Remains
Recovered

FY2018 (9/1/17 – 2/28/18)

MEASURE	Actual as of 2/28/18
# of miles patrolled by grant-funded officers	475,882
# of hours of overtime of grant paid officers supporting the border initiative	62,545
# of intelligence referrals	6,638
# of felony arrests made by grant paid officers supporting the border initiative	601
# of weapons seized	193
# of calls to assist migrants (Brooks County only)	10



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Office of the Governor

Sustain Year-round Flight Capacity

MH- Border Helicopter

Purpose: Rider 23 appropriated funds for border security helicopter operations.

Program Activities:

- Department of Public Safety (DPS) – These grant funds support maintenance for border helicopters using a contractual agreement DPS has with TXDOT Flight Services.

Financial Data:

- **FY2017 (9/1/16 – 8/31/17)**
 - 2 grants*
 - \$3.0M expended
- **FY2018 (9/1/17 – 8/31/18)**
 - 1 grant to DPS
 - \$3.0M awarded

Effectiveness Indicators (Measures):

MEASURE (FY2018)	Actual as of 2/28/18
# of border helicopters receiving maintenance work	15
Total annual flight time for border helicopters (in hours)	3,612

***Note:** The Texas Military Department (TMD) received grant funds in FY2017 that supported personnel, travel, training, and vehicle/helicopter operating costs related to DPS-directed border operations.



Installation and Maintenance of Border Cameras

MC- Border Cameras (TMD)

Purpose: Rider 23 appropriated funds for installation and maintenance of border cameras.

Program Activities:

- Texas Military Department (TMD) – grant funds support staff time for installation and maintenance activities as well as travel and vehicle operating expenses to support camera maintenance.

Financial Data:

- **FY2017 (9/1/16 – 8/31/17)**
 - 1 grant
 - \$630.2K expended
- **FY2018 (9/1/17 – 8/31/18)**
 - 1 grant
 - \$2.0M awarded

Effectiveness Indicators (Measures):

MEASURE	FY2017 Totals	Actual as of 2/28/18
# of cameras installed in a new location during the grant period (does not include replacement cameras)	2447	519
# of existing cameras replaced due to age, wear, or other service issues	1308	116
# of personnel participating in grant-funded operations	66	20



NIBRS Technology

NB – National Incident-Based Reporting System (NIBRS)

Purpose: To enable local law enforcement agencies to upgrade their technology infrastructure to allow for and support the submission of data to the Uniform Crime Reporting (UCR) National Incident-Based Reporting System (NIBRS).

Program Activities:

- Funds may be used for activities that further the reporting of NIBRS data to the Department of Public Safety (DPS). Such activities include, but are not limited to, technology upgrades to existing infrastructure or the purchase of new technology that would allow for the reporting of NIBRS data.

Financial Data:

- **FY2017 and 2018 (9/1/16 – 8/31/18)**
 - 224 grants
 - \$4.68M awarded
- **FY2019 (9/1/18 – 8/31/19)**
 - 142 applications
 - \$15.7M requested



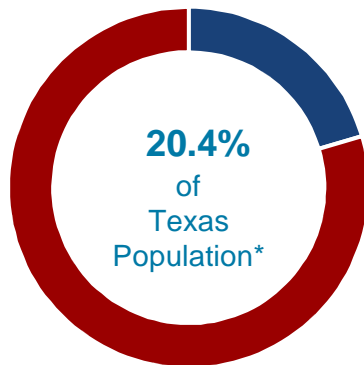
NIBRS Technology

NB – National Incident-Based Reporting System (NIBRS)

Effectiveness Indicators (Measures):

FY2017 and 2018 (9/1/16 – 2/28/18)

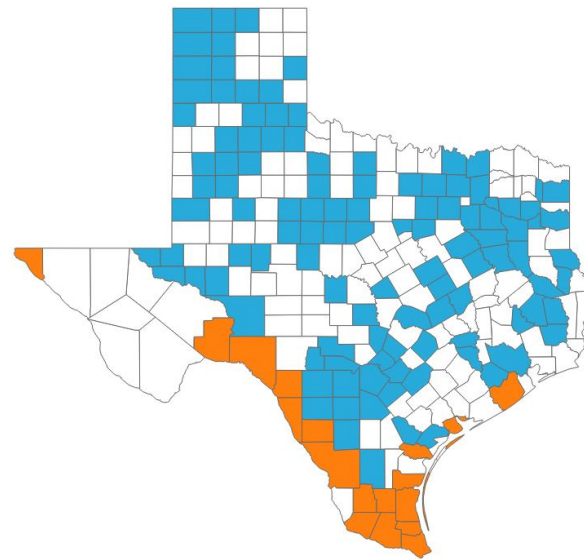
Each agency must undergo a 1-3 month testing phase with DPS before the agency may be deemed NIBRS compliant.



**173 NIBRS
Compliant Agencies**

*UCR Jurisdictional Population

Areas of Texas covered
by NIBRS grant awards



Homeland Security Grants Division, Public Safety Office
Office of the Governor

Anti-Gang Activities

AG – Anti-Gang (TAG)

Purpose: To eradicate the presence of violent transnational and other organized gangs within the geographic regions of Texas, thus ensuring the security and safety of Texans and citizens of neighboring states.

Program Activities:

- CJD funds six (6) TAG Centers which are co-located law enforcement facilities underpinned with strategic and formal partnerships among specialized federal, state, and local law enforcement agencies.

Financial Data:

- **FY2017 (9/1/16 – 8/31/17)**
 - 3 grants
 - \$4.07M expended
- **FY2018 (9/1/17 – 8/31/18)**
 - 5 grants
 - \$5.17M awarded

BPU funds five (5) prosecutors working at Texas Anti-Gang Centers (one each in El Paso, Hidalgo, Bexar, Harris and Dallas Counties). TAG prosecutors work alongside state, local, and federal law enforcement officials on a daily basis. Information sharing has been paramount in the successful investigation of gang members, human traffickers and drug dealers.



Anti-Gang Activities

AG – Anti-Gang (TAG)

Effectiveness Indicators (Measures):

FY2017 (9/1/16 – 8/31/17)



FY2018 (9/1/17 – 2/28/18)

MEASURE	Actual as of 2/28/18
# of gangs targeted	114
# of felony arrests	500
# of participating agencies	52



Federal Funding

HS – Operation Stonegarden (OPSG)

Purpose: To support enhanced cooperation and coordination among Customs and Border Protection (CBP), United States Border Patrol (USBP), and Federal, state, local, and tribal law enforcement agencies. The OPSG Program provides funding to support joint efforts to secure the United States' borders.

Program Activities/Process:

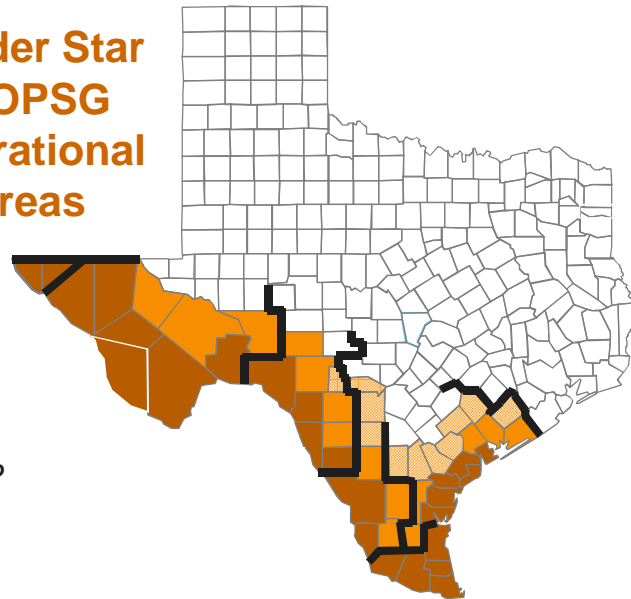
- Funds are used to provide an enhanced law enforcement presence and to increase operational capabilities promoting a layered, coordinated approach to law enforcement within Border States. Integrated Planning Teams (IPT) meet to establish the Campaign Plans and tactical Operations Orders once funding is approved by DHS/FEMA.

Financial Data:

- **FY2017* (9/1/16 start or later)**
 - 83 grants
 - \$19.8M awarded
- **FY2018* (9/1/17 start or later)**
 - 23 grants
 - \$5.01M awarded

**Notes: FY2017 is from 2016 HSGP; FY2018 is from 2017 HSGP*

**Border Star
& OPSG
Operational
Areas**



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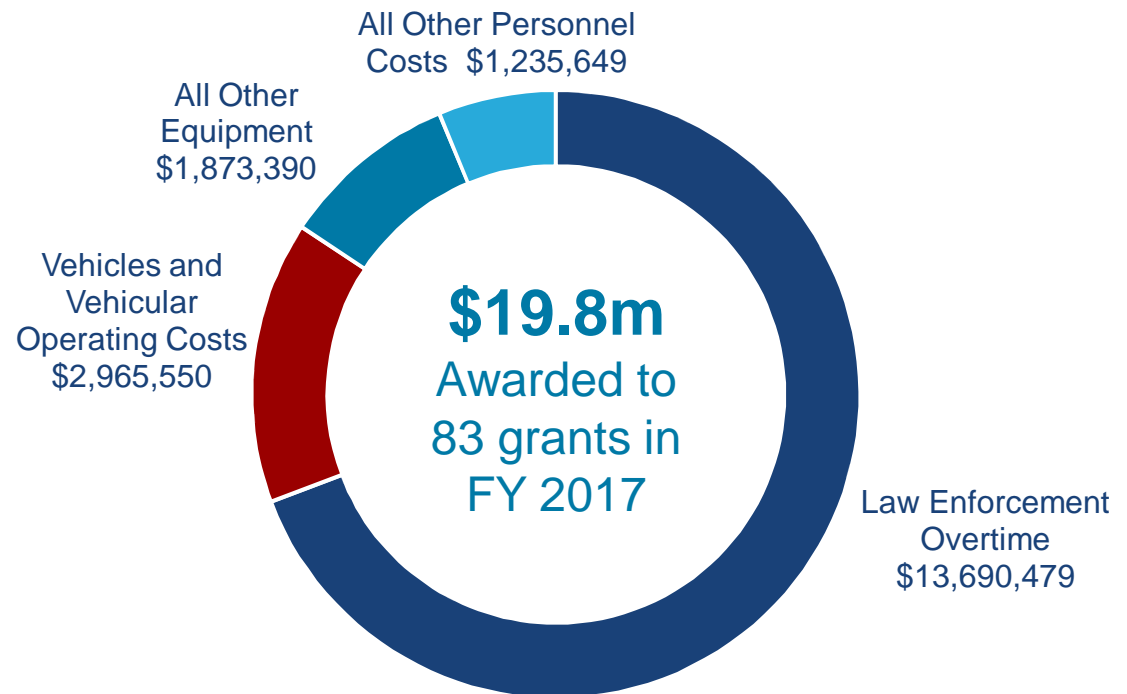
Federal Funding

OPSG supports successful operational collaboration among multiple agencies



OPSG funding primarily supports the overtime of law enforcement officers involved in border security operations.

314,851 overtime hours logged



Homeland Security Grants Division, Public Safety Office
Office of the Governor

Texas House of Representatives
Appropriations Committee
E1.030
April 18, 2018
10:00 a.m.

Texas Parks and Wildlife Department
Law Enforcement Division
Texas Game Warden

Colonel Grahame Jones, Director of Law Enforcement

The Texas Parks and Wildlife Department's Law Enforcement border mission is to protect the State's diverse, valuable, and fragile natural resources. Additionally, game wardens protect the citizens of Texas by providing water safety, search and rescue, general law enforcement, and public safety duties. We accomplish this mission by supporting and working with local, state, and federal law enforcement partner agencies, other TPWD Divisions, NGOs, landowners, and the public.

Texas Game Wardens have patrolled the border region for more than a century. Game Wardens patrol the Gulf of Mexico, Laguna Madre, Rio Grande, Falcon Lake, Amistad Reservoir, rural ranchlands in south and west Texas, and communities along the border protecting both our natural resources and citizens. On a daily basis, Texas Game Wardens assist our partner law enforcement agencies including the Texas Department of Public Safety, Sheriff Departments, Police Departments, and U.S. Border Patrol. In many cases, Game Wardens are a critical force multiplier to numerous state and federal agencies as well as rural local law enforcement agencies.

Our Border Mission

- Leverage maritime expertise and off-road capabilities, relationships within the community – including landowners, and knowledge of waterways and rural areas to:
- Reduce the likelihood of water related fatalities by enforcing the Texas Water Safety Act

- Protect the natural resources of Texas which includes the enforcement of illegal commercial fishing by reducing gill-netting and long-lining from Mexican commercial fishing fleets.
 - We are observing an increase in numbers of incursions by commercial fishing vessels entering into Texas Waters from Mexico.
 - The vessels from Mexico are taking a large and ever-increasing number of reef fish including red snapper, sharks (primarily for their fins), and red drum.
 - Gill nets and long-lines are illegal in Texas / US waters and indiscriminately kill marine life. We have recently documented dead dolphins, sea turtles, Osprey, Pelicans and many fish species including sailfish, King Mackerel, sharks, red drum, spotted sea trout, snook and other fish in gill nets and on long-lines set by fishing fleets from Mexico. When abandoned, Gill nets and long-lines, continue to kill large volumes of marine life.
 - We have also seized thousands of pounds of marijuana on Mexican fishing vessels as well as illegal fishing equipment and in some instances illegal fishing equipment and hundreds of pounds of marijuana on the same vessel.
 - Once observed, these vessels attempt to evade capture and initiate a pursuit. Most of the time, the vessels outrun our vessels and return to Mexico prior to capture. We routinely engage in more than 100 pursuits with vessels from Mexico on an annual basis.
 - In the last four years, we have seized 140 miles of long lines and 20 miles of gill net containing thousands of fish and other marine life.
 - U.S. recent Fishery Impact Estimate by the USCG determined:
 - Estimated 1,138 lancha incursions/year
 - Typical catch for one lancha is 800 – 1,500 lbs/trip
 - Larger lanchas are known to catch upwards of 3,000 lbs/trip
 - 1,525,715 lbs of red snapper poached from U.S. waters by MEX lanchas over the past 2 years

- Additionally, our border mission includes supporting landowners by reducing poaching, trespass, illegal dumping, fence cutting, vandalism, theft, and other property related crime
- We also routinely extend humanitarian support to persons including women and children needing immediate medical assistance and Search and Rescue and have provided lifesaving emergency medical treatment to UDAs including mouth-to-mouth resuscitation.
- We have maintained on-going border surge operations since June 2014 in support of Operation Strong Safety and now Operation Secure Texas.

The Law Enforcement Division was appropriated 7M in border funding during the last legislative session. These funds are being utilized for equipment (including repair and maintenance), training, fuel, Game Warden and State Park Police overtime, travel, lodging, and Game Warden salaries relating to our border mission and border operations.

Maintaining the 7M over the biennium in the Division's base budget is crucial to our on-going patrol and enforcement efforts along the Texas / Mexico border. In addition to daily land and water patrols, Texas Game Wardens have organized and conducted 19 border operations since September 1, 2017.

Texas Alcoholic Beverage Commission Border Security

House Appropriations Committee

April 18, 2018



TABC Border Security Appropriations

- Appropriated \$1.2 million for 2016–2017 biennium
 - Included an additional 6 FTEs for “Special Investigation Agents”
- \$1.2 million and 6 FTEs were funded again for FY2018–2019
- For FY2018–2019, \$5.7 million of the agency’s baseline appropriations was designated as border security
 - This \$5.7 million was not additional funding but existing appropriations



TABC Border Security Appropriations

- TABC identified 36 existing FTEs as baseline expenditures for the \$5.7 million
- All FTEs are assigned to work in counties as defined in Article IX, Sec. 7.11(b) of the 2018 – 2019 GAA
- Agents are assigned to offices in El Paso, Corpus Christi, McAllen, Laredo, Fort Davis, Del Rio, Hondo, Victoria, Beaumont, Wharton and Galveston



Border Security Expenditures

<u>Biennium</u>	<u>Funded</u>	<u>Total Expenditures</u>
2016–2017 Special Investigation Agents	\$1,184,618	\$1,142,296

<u>Biennium</u>	<u>Funded</u>	<u>Projected Expenditures</u>
2018–2019 Special Investigation Agents	\$1,184,618	1,184,618
2018–2019 Baseline Border Expenditures	\$5,715,382	\$5,715,382
TOTAL	\$6,900,000	\$6,900,000



Application of Funds

- Investigate public safety complaints and suspected organized criminal activity at TABC-licensed business in the border region
- Leverage resources by participating in multiple task forces, including FBI, Homeland Security, Customs, DPS, Houston PD and more
- Conduct operations focusing on drugs, human trafficking, money laundering, and other criminal activity
- 25% of all investigations conducted by TABC's Special Investigations Unit are in the border region -- 10% of which involve allegations of human trafficking



Operation TNT

Long-term investigation of narcotics sales at six El Paso bars located within a Drug Free Zone

- Investigation began in early 2015 at two locations then expanded
- More than 200 operations conducted with frequent street-level narcotic buys
- All six TABC-issued permits were cancelled for cause in 2017
 - 81 total administrative violations
- Arrests were conducted with the assistance of EPPD, DPS and HSI
 - 49 Felony warrants on 17 individuals

